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SHORT LINE AND REGIONAL RAILROADS

HEARING

BEFORE THE

SUBCOMMITTEE ON
SURFACE TRANSPORTATION

OF THE

COMMITTEE ON COMMERCE,
SCIENCE, AND TRANSPORTATION
UNITED STATES SENATE

NINETY-NINTH CONGRESS

SECOND SESSION

ON

ESTABLISHMENT OF NEW SHORT LINE AND REGIONAL RAILROADS

JULY 25, 1986

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ESTABLISHMENT OF NEW SHORT LINE AND REGIONAL RAILROADS

FRIDAY, JULY 25, 1986

U.S. Senate,
Committee on Commerce, Science, and Transportation,
Subcommittee on Surface Transportation,
Washington, DC.

The subcommittee met, pursuant to notice, at 9:33 a.m., in room SR-253, Russell Senate Office Building, Hon. Bob Packwood (chairman of the subcommittee) presiding.

Staff members assigned to this hearing: Pamela Garvie, staff counsel and Linda Morgan, minority staff counsel.

OPENING STATEMENT BY SENATOR PACKWOOD

Senator **Packwood**. The committee will come to order, please.

The purpose of today's hearing is to gain a better understanding of what has been described as one of the most important developments in recent railroad history—the growth of the short line and regional railroad industries.

The statistics are impressive. Since 1980, the number of short line railroads has increased by one-third, from 200 to 300. They employ 80,000 people, which is about one-fourth of the entire rail work force. The numbers are expected to grow by leaps and bounds in the future.

However, more important than the statistics is the fact that the formation of these new railroads often results in the preservation of rail service that would otherwise be abandoned. The preservation of this service is vital to shippers, communities, and employees alike. Two examples come from my own State, where Lake County and the Port of Tillamook Bay have formed railroads to operate service on lines that otherwise would have been abandoned and the track scrapped. In the case of Lake County, such abandonment would have resulted in the closure of four lumber mills and the loss of 220 jobs.

During today's hearing we will be examining a number of questions, including: One, what are the factors that contribute to the successful formation and operation of short line and regional railroads; two, what sources of financing are available for the purchase and rehabilitation of rail lines; three, are there public programs available to help provide management and marketing assistance to short line railroads; four, what responsibilities do the selling railroads have to provide through routes and joint rates for the new railroads; five, what responsibilities do shippers have to tender traffic to the new railroads; six, should the Interstate Commerce Commission be required to impose labor protection in line sale transactions and, if so, what would be the impact on such transactions; and, last, are there any actions Congress should take to encourage the formation and the operation of short line and regional railroads.

To address these questions we have invited an excellent group of witnesses, including two from Oregon, whom I would personally like to welcome—Claudia Howells of the Oregon Public Utility Commission, and Ed Immel of the Oregon Department of Transportation.

We will start our hearing this morning with Mr. John Riley, who is the Administrator of the Federal Railway Administration. Good morning, Mr. Administrator.

STATEMENT OF HON. JOHN RILEY, ADMINISTRATOR, FEDERAL RAILROAD ADMINISTRATION, ACCOMPANIED BY LOU THOMPSON, OFFICE OF PASSENGER AND FREIGHT SERVICES

Mr. **Riley**. Good morning, Senator. With me this morning is Lou Thompson, who heads our Office of Passenger and Freight Services, and Lou has the special job of going out into the field and working with short line railroads and lines about to be divested and shippers along those lines.

Senator **Packwood**. Mr. Thompson, good to have you with us. If at some stage, John, I get up and leave, I am involved up to my neck in the tax conference, and I will be going back to meet with the chairman of the Ways and Means Committee on that subject.

Mr. **Riley**. As important as this is, I think that is even more important, and we are glad you are doing that. That shows a good choice of priorities.

Senator **Packwood**. Thank you. Go ahead with your statement.

Mr. **Riley**. Thank you, Senator.

Although it has not made headlines yet, the issue that this committee is focusing on this morning is likely to be the dominant issue before the railroad industry over the next decade, and it is essential to recognize at the onset that the future of short lines and the future of service to communities that are situated on light density lines throughout this country are inseparable issues.

These light density lines will ultimately either be abandoned or transferred to independent carriers, and as public policymakers we have an enormous stake both in promoting the development of short lines and in clearing away obstacles that would prevent the successful transfer of these lines to people who want to operate them. I really do commend the committee for getting out in front of this issue.

We have learned over the last decade that light density lines which cannot be operated profitably within the economics of a major carrier often can be operated profitably in the context of a short line or a small regional railroad operation. And there are several reasons why.

Lower cost is obviously one of them. The smaller railroad has lower overhead. It can maintain a less costly equipment inventory. It will normally maintain its tracks to different standards. And, most important, the small railroad, whether it is union or nonunion, is not likely to be encumbered by the strict craft lines and work rules that tend to typify major carrier agreements. So what that means is that the short line carrier can use the talents of a single employee on multiple tasks rather than employing several individuals on a full-time basis when their services are needed only a portion of the time.

In addition, the smaller railroad can indulge in locally oriented marketing and local service, so that it can compete both with marketing and service in a way that the class I often cannot. You can look all around the country and see tangible examples of these factors at work, and we have literally had an explosion in the number of short lines created in the last few years.

As the chart to my right demonstrates, in the 1950's 16 small railroads were created; in the 1960's, 12; in the 1970's, in the aftermath of the Penn Central collapse, 47. But in the last 6 years, in the 6 years since the Staggers Act, 133 small carriers have sprung up around the country. Now obviously this reflects increased effort by the major carriers to rationalize their systems. But it also demonstrates increased success in maintaining service over lines which a decade ago would have been abandoned, pulled from the ground, and sold for salvage.

There are about 393 independent carriers nationwide today, not counting the roughly 80 small railroads owned by the major carriers. And, as you can see, while we have some major systems developing in the 600- or 700-mile range, the great bulk of those independent carriers continue to be quite small, as the second chart illustrates.

Now, as we look out to the future, recognizing that most of the major carriers are about to implement major system rationalization programs, and the ICC's decision yesterday certainly is going to spur the abandonment and sale of many, many lines in the Southwest, it is clear that, barring major revisions to the Staggers Act, the trend toward formation of small regional carriers is certain to continue and accelerate in the rest of this century.[1]

Now that is not to say—and it is important to emphasize this—that short line transfer is the right solution for every light density line. For all the success stories, it is essential for shippers and investors to be realistic in assessing the potential of these lines on a case-by-case basis.

To survive over the long term the line must have an adequate traffic base and shippers must assess that base realistically. Shipper investment in the line or the carrier is material, since it gives the shipper a financial incentive to keep its traffic on the line rather than simply using its existence as a price leverage on trucks. It also gives the local shipper an incentive to go out and recruit more local volume for the line.

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[1] Many of the branch lines shed in the 1960's and 1970's were truly deteriorated lines—with little or no traffic, and enormous rehabilitation needs. The abandonment of these "loss leaders" has now been largely completed, and the railroads are focusing today's rationalization efforts on lines that are better maintained and better endowed with traffic, though still too light in density to be a contributing part of a major carrier's system. The chance for preserving service on these lines with an independent railroad is much greater, and since the *Gulf & Mississippi Railroad* decision (Finance Docket No. 30439 *Gulf & Mississippi Railroad Corporation-Purchase [Portion]-Exemption-Illinois Central Gulf Railroad Company* Decided: December 13, 1984), the willingness of the major carriers to cooperate in this effort has never been stronger.

It is also essential to objectively assess the condition of the line and conservatively estimate capital investment needs over both the short and the long run. Short-term investment—the cost to get the line up and running—may bear very little relation to long-term investment needs, particularly where bridge work or steel replacement are involved.

The key question is: Can the line generate enough return to amortize these costs and is there a reasonable possibility that the line could qualify for public rehabilitation funding in the 22 States that offer it?

The operator has to have capital that goes beyond the foreseen costs to cover the unforeseen, such as floods and derailments, which often end service on small carriers. And, finally, the operator must have adequate class I connections, with rate divisions sufficient to ensure profitability.

In the decade of the 1970's, 159 small railroads went bankrupt or were abandoned, which is a sober reminder of the consequences of poor or overoptimistic judgments.

Looking out to the future, there are several issues which are controversial but I think they need to be raised, and I would like to, as the first witness this morning, highlight those issues for the committee to comment on and for the speakers after me to comment on.

No. 1, in our judgment at FRA it is essential to preserve the labor protection guidelines established by the ICC in the *Gulf & Mississippi* case. In that case, the ICC provided a powerful incentive for carriers to preserve and transfer, rather than simply abandon, light density lines by ruling that New York Dock and Oregon Short Line labor protection is not mandatory when carriers sell a line to a new independent railroad.

As the committee knows, the protective provisions of New York Dock and Oregon Short Line would require the seller or buyer to provide up to 6 years full salary and benefits to employees affected by the transfer. Imposition of these labor protection obligations materially alters the economics of many light density lines, and the risks they add to the transaction are a disincentive to private investment.

Equally important, the ability to sell a line free of residual protection obligations is a strong incentive for the major carriers to support short line operators, both logistically and financially, rather than opting to abandon the line. And reversing that incentive is not in the public interest.

Any one who worked, as I did and my friend, Larry Long, who is in the audience here today did, back in the 1970's out in this area carries memories of the hostility demonstrated by many major carriers toward short line operators. And short lines are in fact competitors with the major carriers for some traffic. For that reason, many class I carriers favored abandonment and salvage over short line creation.

That attitude changed virtually overnight with the *Gulf & Mississippi* decision. Today most major carriers have established planning groups that analyze light density lines and identify those with the best potential for short line operations. Some carriers, like the Southern Pacific, are actually packaging lines for sale to potential operators, and in several cases the class I carrier has provided financing to ensure completion of the deal.

Most important, the class I carriers are cooperating in establishing joint rate and division agreements with short line operators on their former branches. These are positive developments, and it is essential to recognize that imposition of labor protection on these types of cases would undermine both the economics and the attitude of cooperation that have made the rapid growth in short line railroad development possible.

In the larger divestitures, like the recently established Chicago Central and Pacific, labor and management have been successful in negotiating agreements which satisfy labor's demands, but at cost levels consistent with the needs of the regional railroad. There is no reason to believe these issues cannot continue to be resolved on a case-by-case basis. To legislatively mandate New York Dock or Oregon Short Line protection on all light density divestitures amounts to a direct tradeoff between protection on the one hand and jobs and service on the other.

The second issue. It is essential to recognize that reasonable distinctions between larger and smaller railroads in the formulation of Federal rules and policies. Mandated costs and reporting requirements place a greater burden on small carriers, which have a smaller traffic base over which to spread their costs. We need to build flexibility for the smaller carriers into our statutes and rules wherever it is reasonable to do so.

Third, the availability and cost of insurance will continue to be a major issue for smaller carriers, and I know, Senator Pressler, that, you have been very active in this area and this field. It would be very difficult for the small railroads to do what the major carriers have done and establish a captive insurance company, and they have much smaller volume across which to spread their insurance costs.

The committee needs to weigh that factor in making its judgments on the varied and complex insurance issues now before it. One issue that needs to be analyzed with particular care is the impact of the Federal Employers' Liability Act [FELA], on these smaller carriers. FELA is an extremely expensive compensation system, one in which a high percentage of dollars goes to middlemen, lawyers. I used to think that was a good idea before I came to Government, when I was practicing. I have changed my mind.

This burden falls particularly hard on small carriers. I think the committee should consider options ranging from revising the system in a way that would protect the worker but lighten the burden on the companies by reducing the middleman's share, or by giving smaller carriers the ability to elect State workers' compensation coverage where possible. I really do believe you can come up with a FELA solution that leaves the worker protection intact and still lowers costs.

Finally, it is essential to recognize the importance of the Staggers Act ratemaking flexibility and contractual powers to the successful operation of a short line railroad. Protection of these reforms is an essential element in any overall small railroad policy.

Senator, I want to say clearly that in the last several years we have shared your goal of promoting short line development, and I would like to wrap up my testimony this morning by noting several things that we have done in our policies at FRA to promote the development of small railroads.

First, while we generally require railroads, regardless of size, to meet the same safety standards, we have substantially altered recordkeeping and reporting requirements applicable to smaller carriers. Two paperwork reduction rulemakings were completed in 1985, and we have provided special relief for short line carriers in virtually all of our new rulemakings over the last 2½ years.

Second, we have crafted a special exemption from FRA track standards to permit continued operation on agricultural branch lines that would otherwise be unable to bear the expense of meeting FRA standards. There are thousands of miles of deteriorated light density rail line serving elevators throughout the grain belt. For the shippers they serve, these are important connections, but their shipping volume is much too light to finance the type of maintenance needed to keep the track in conformance with FRA standards.

To make it possible for these short lines to exist, we have created a special exception to our standards when no hazardous material moves on a line and when no traffic moves at speeds in excess of ten miles an hour. There are many short lines operating today in the Midwest and parts of the East solely because of this excepted track provision, and we think it has been a real success.

Third, one of the most difficult problems facing communities served by light density lines—and the chairman referred to this in his opening statement—is the need for expertise, the need for unbiased advice on how to cost out options, what information to seek from carriers, how to locate and evaluate potential short line operators. And when abandonment is imminent these decisions have got to be made in the very short run.

FRA has taken the initiative in assisting shippers in communities confronted with these problems by creating a strike force which Lou manages, which on request from shippers or community officials will inspect the line in question and help shippers intelligently assess their options. Over the past 2 years, the strike force has worked with shippers in communities from South Dakota to Louisiana, from South Carolina to the State of Washington.

It assisted in the expansion of Dakota Rail, which serves both South Dakota and Minnesota now, and after last year's disastrous flooding in the East it assisted small railroads in West Virginia and Pennsylvania in estimating their rehabilitation costs.

Finally, FRA continues to administer a variety of appropriations under remaining grant and loan programs. Section 401 of the 4R Act continues in force and effect, which gives us the authority to grant transactional antitrust immunity for restructuring discussions involving smaller carriers. And this could be very important when the ideal short line configuration to emerge from a restructuring is composed of spunoff lines from two or more class I railroads.

Senator, I really believe that the committee is out on the cutting edge of what is going to be the most important issue in the railroad industry through the remainder of this century, and I really commend, genuinely commend, the committee for doing it. We look forward to answering any questions you may have and to continuing to work with you in the months and years ahead on this issue.

OPENING STATEMENT BY SENATOR PRESSLER

Senator PRESSLER [presiding]. Thank you very much. Since I arrived after the chairman I will make a brief opening statement myself at this time, and call on Senator Rockefeller for any opening statement he might have.

Let me first say that in calling for these hearings I recall that 2 years ago I took a train ride in South Dakota, which is fairly hard to do since we do not have passenger trains, but it was a specially-arranged train ride. We had just finished a 2½ year fight with one of the major railroads in our State which culminated in a very tough yearlong abandonment fight. We had been very fortunate to win that round but knew that the 200-mile stretch of railroad we had been fighting over was destined for doom unless we could work out a long-term solution.

To make matters worse there were 300 to 400 miles of additional trackage in the State that were already in the marginal category and expected to go the way of the others in the not too distant future. At that point everyone was tired of fighting. I proposed that we all—shippers, labor, the railroad, the local communities and others—get together to discuss the problem and attempt to address it in a positive way.

We spent an entire day traveling across the State in a Chicago & North Western car. I was amazed to discover that in the entire 3-year process this was the first time that all the parties had ever sat down together, with the possible exception of the abandonment hearings. Much to everyone's surprise, we got along.

The end result of that meeting was a decision by Chicago & North Western to study a new kind of plant rationalization for the light density branch lines. Another dozen or so meetings followed. Then, in September of last year, I conducted a statewide rail conference at which we first publicly announced the plan to divest roughly 900 miles of Chicago & North Western system to an independent operator. We had some of the best rail experts from around the country at that conference. Although the 100-plus page transcript is too lengthy to have printed, I make it a part of this hearing record today as a valuable resource document.

At any rate, to conclude the story, today in South Dakota we are putting the finishing touches on a transaction which will create a new 900-mile regional railroad, the Dakota, Minnesota and Eastern. We will hear the rest of the details later from two of the witnesses involved in that transaction.

I think this story is a good beginning point for today's hearing. It is illustrative of the latest and one of the most significant new trends in the railroad industry today—the creation of regional and short line railroads through the divestiture of light density lines from larger class I railroads. In particular we will be looking at this new type of plant rationalization as an alternative to rail abandonments.

We will study the development and reasons for this trend, discuss its merits and problems, consider ways of encouraging this activity as an alternative to rail abandonment, and explore ways to ensure that it is not utilized for some unproductive purposes such as unionbusting or backdoor abandonments.

Let me begin by outlining just a few of the things we are particularly interested in exploring today. First we want to find out what really has been happening in this area. We know that there is a lot of activity out there, but as yet we have not been able to develop hard statistics as to the actual number of new lines, the type of lines, the amounts of trackage and traffic, the success failure rate, the labor statistics and so forth.

Second, we want to find out how these lines tick. Why can they operate more efficiently than larger railroads? How are they operating? Who runs them? And what can we expect of them in the future?

Third, is it good public policy to encourage creation of these lines and, if so, how do we go about doing it?

Finally, how can we make certain that these lines are not being used for unproductive purposes?

Hopefully we can explore all these issues today. I must admit that I come to this hearing with a bias in favor of this development. It has been a very positive thing for my State. We have saved hundreds of miles of railroad. We have gained a new corporate citizen of whom we are particularly proud, retained service, and saved hundreds of jobs. So I am somewhat predisposed but nevertheless have an open mind on the many aspects of this issue.

Before continuing, I want to touch just briefly on a few of the specific issues and then get on with the hearing.

LABOR

This is clearly one of the most controversial yet important issues in this area. The central question deals with the labor protection, but I want to explore the issues of wages, work rules, productivity, job security, and the effect that secondary boycotts may have on regional or short line railroad development.

Frankly, I have a hard time understanding the rationale behind the present distinctions between transactions where labor protection is invoked and those that are exempt. I find it hard to understand why labor protection would apply when a 50-mile short line purchases another line 10 or 20 miles long, while it may not apply when a nonrailroad purchases a 5,000-mile system. I think it may very well make sense to take a look at the size of the properties involved as the entities.

OTHER EFFICIENCIES

As important as the labor issue is, I think it is often overemphasized in its importance to those transactions. There are many other efficiencies to be realized, such as management consolidation, marketing concentration, increased service potential, coordinated operating agreements, and so forth. We need to better understand and more fully explore these areas.

LIABILITY INSURANCE

This is one area, it appears to me, in which regional and short line railroads are disadvantaged vis-a-vis the class I's. They are not big enough to self-insure and therefore are saddled with huge liability insurance premiums or have to tie up a prohibitive amount of capital in cash-retention pools. We are all aware that the liability crisis transcends the railroad industry, and there is much being done in an attempt to address that problem.

I have spent a considerable amount of time on that issue in this committee. We recently reported a very important product liability bill and a risk-retention bill. Much work remains in this area.

But there are specific problems unique to the railroad industry. While the rest of the world operates under the workman's compensation rules, railroads are subject to much higher limits of liability under the Federal Employers' Liability Act.

This law, enacted prior to worker's compensation statutes, seems to apply a dual standard to the railroad industry. I am currently in the process of studying this issue and may introduce legislation yet in this Congress to reform FELA or replace it with some type of worker's compensation statute. The Federal Government has recently taken an increased interest in reforming State tort laws. It seems to me that we may want to consider doing our own housecleaning first.

FINANCING

If we are truly interested in encouraging regional and short line railroads as an alternative to abandonment, I think financing is an essential element in the equation. There are several classifications of light-density lines in terms of economic viability. There are those that are profitable even for the class I railroads but even more so for regional independent operations.

Then there are those which are not profitable for class I railroads but can be made profitable through divestiture to an independent operator. Finally, there are those which without some type of financial assistance are not profitable, at least initially, to either railroad but still serve an extremely important public interest to the local communities, shippers, and farmers in the surrounding area. It is this latter category we need to address in terms of financial assistance in some form or another.

COOPERATIVE AGREEMENTS AND RAILROAD RELATIONS

If there is anything I learned about the issue through our recent South Dakota experience it is that the initial and ongoing cooperation of the class I railroad is the most important ingredient in making these transactions work. C&NW has been extremely cooperative throughout the process and I am certain they intend to continue in that spirit. Our problem could not have been solved without its help.

But I am concerned about what might happen 5, 10, or 20 years down the road not only to the line in South Dakota but with regional and short lines throughout the country. They are, by and large, very dependent upon the class I's for continued viability and success. I am concerned about the future of other lines which today may very well be successful independent operations but, if left to deteriorate a few more years through deferred maintenance, would fall into the third category I mentioned earlier.

There seems to be a point at which a line is no longer profitable for a class I if it has to continue a maintenance schedule sufficient to keep the line in good operating condition. We cannot allow the line to deteriorate to the point beyond which even a short line or regional railroad cannot make it viable. I do not have the answers to these questions. That is one of the many answers we are looking for today.

These are some of the concerns I have in this area. I hope the witnesses can help us address them today, as the first witness has. We will not be able to solve all the problems today, but I hope this hearing will provide a good start in a process on which I intend to spend considerable time and effort in the following months and years.

With that I will close my formal remarks and get on with the hearing. I will call on Senator Rockefeller for any opening statement he may have.

OPENING STATEMENT BY SENATOR ROCKEFELLER

Senator **Rockefeller**. Thanks, Mr. Chairman. I apologize to you, Mr. Riley, for being late. You are accustomed to these matters.

Just a very short statement on an important subject. The growing presence of short line railroads really is an important development in rail transportation, and especially in the aftermath of regulation. Likewise, the existence of short lines has been an absolutely critical factor in States such as my own, the State of West Virginia, where the availability of rail transportation is fundamental to the movement of goods.

West Virginia is about 96 percent mountainous and about 4 percent flat. And therefore railroads have a very, very great importance to us. We have eight active short line railroads in the State at this time. They are tremendously important to the coal industry, which is basic to West Virginia, and we also have a short line railroad called the South Branch Valley Railroad, which some people refer to as the chicken line because it in fact supports a very major, in fact one of the 20 largest poultry industries in the entire country.

The South Branch Valley Railroad is the only railroad in this country which is not only State-owned but State-operated, and I am glad to say that when I was Governor of West Virginia in 1978 we effected that change, working with the Chessie system, and in its very brief existence it has been a short line success story. It was on the verge of abandonment by the Chessie system, but it is now operating and serving not only the poultry operators that I referred to but a variety of other industries as well over several large counties.

Now there was a flood there last year, Mr. Chairman, which devastated the railroad, and the progress has been slow. But its rehabilitation is proceeding with the determined hard work of many West Virginians, the State of West Virginia, and the Federal Government, through the involvement of the Local Rail Service Assistance Program, LRSA. In fact, Mr. Chairman, LRSA has been, for the South Branch Railroad and many short lines in West Virginia, a key to continued existence.

That small, unknown Federal program has been a key to commerce in West Virginia. That is why you and I, Senator Pressler, fought very hard together to work out a compromise to maintain basic funding for this program, which the administration has wanted to eliminate, and I hope that this committee will find a way to fund the LRSA Program not only this year but in future years as well.

The creation of short lines is a growing occurrence, Mr. Chairman, as you well know, and it is an important ingredient in the future of rail transportation in this country, particularly with rail deregulation that is in place now. To be quite honest, the large railroads are increasing their abandonment efforts, where they find a rail line that does not fit conveniently with their main line system and does not produce profits for them. They are very quick to abandon.

Now that can be academic up here in Washington, but it is not academic in a State like West Virginia or other rural States where when a major railroad abandons its tracks the economy simply fails. People have to understand that, that there are a lot of communities in West Virginia and other rural States where the short line railroads are the difference between economic viability and a collapsed economy.

I think we have to be very vigilant here in Congress, Mr. Chairman, and with the people in the regulatory agencies we must be more vigilant in our examination of the justification for stripping railroad infrastructure from our landscape. We are never again in this country going to have the luxury to build the vast extent of rail lines that we now have. That chance is gone. It will never come again, and we better do what we can to preserve what we have as best as we possibly can.

In this regard, I would say, Mr. Chairman, that the Interstate Commerce Commission shirks, in my judgment, its duty to allow the public and many communities to express themselves with respect to potential abandonments. I think people need to be allowed to express their views to a regulatory agency of the Federal Government for which they pay the taxes before abandonment takes place on a much more regular basis than is currently the case.

We will get into that matter more a little bit later with the Interstate Commerce Commission chairman. But, Mr. Chairman, you and I worry about these things. There are not many Senators at this hearing this morning, and that worries me, too, because this is not a major part of the American economy that we are talking about, but it is a part of the economy in our States and small States which needs attention and which needs help, and Government, private industry, and citizens must work together to make it work at all.

I thank you.

Senator PRESSLER. Thank you very much.

Senator ROCKEFELLER. I have questions for the witness, but I assume you do first.

Senator **Pressler**. I will ask one or two questions, and then you go ahead.

I want to thank you, John Riley, for your testimony. On this issue of labor protection, give me your analysis of that regarding the short line railroads and where we are heading. I have never quite understood the rationale for the railroad/nonrailroad distinction in invoking labor protection. Could you describe that for me and why should a tiny short line operator have the same labor protection standards applied to it as to merging giants?

Would it make sense to extend the labor protection waiver to smaller railroads who are purchasing another small railroad?

Mr. **Riley**. On the latter part, Senator, I think the answer to that is yes, and I am not going to—let me answer that question on the economics. I am not going to defend the distinction that the Commission has set up because I have some of the same questions about it that you do. But I do believe that, particularly when you look at the smallest lines reflected on that chart, the impact of mandating labor protection fundamentally changes the economics of the smaller line, and the smaller the line the more true that is.

It does several things. Well, refer back to what I said in my opening statement. *The Gulf & Mississippi* decision not only made many of these smaller lines more economically viable by automatically lowering their overhead costs, it made the lines more attractive to private investors by lessening the risk that the private investor, who is usually a shipper, is going to have to face.

But probably more important than either of those factors, it changed the attitudes of the class I railroads. I frankly believe, Senator, that I wholeheartedly endorse everything you said about the South Dakota program. I think what you have done in South Dakota and what we did in Minnesota in the aftermath of the Milwaukee reorganization are models for the country. But I remember so vividly how hard it was to get the class I railroads to work with and support these short line developments.

Gulf & Mississippi changed that. It gave them an economic incentive to support divestiture of the line rather than simple abandonment. Any short line competes to some extent with the class I carrier because some of that traffic would go directly by truck to the main line of the class I carrier, no interchange, no division. And that was enough to get them to oppose short lines for many years.

Gulf & Mississippi changed that because it gave them an economic upside to transfer over abandonment. I think that distinction between transfer and abandonment is a sound one, and it is a critical one.

As to where the Commission has drawn the distinction, I frankly am no better able to explain it than you are, Senator, and perhaps the Commission can say that. But I think that is where it should be drawn, between abandonment and transfer, because in abandonment the worker does not have the job any more at all; in a transfer the worker still does have a job. And that is a good rationale for not imposing the labor protection there.

If you do impose it, it is just a tradeoff between protection and jobs. You gain protection, you lose jobs.

Senator PRESSLER. How do we avoid allowing track to deteriorate to a point of no return, making abandonment the only option? I guess you know the cycle as well as I do on that.

Mr. RILEY. That is a very good question, probably the imponderable question. I really developed a conviction before I came to Government that the rural light density line was the biggest loser in a heavily regulated system because when you put a cash squeeze on railroads you do what any rational businessman would do; they pour their resources into the areas of the system that produce the greatest return.

And I think the decades of over-regulation that we lived with really undermined the survivability of a lot of rural branch lines because the cash-poor railroads poured their resources into the main lines. And that really is a tragedy because there are lines out there that I have seen—and I know that you have seen—that if they were in workable condition probably could amortize their annual costs. But the challenge comes in how you get them from where they are to a point where they could really run.

Senator, I have no more really complex analysis of that one that I am able to give you. I think that I guess I would conclude with two comments. Keeping the railroads with good cash flow is obviously a factor. I think a second factor is to make sure that every rail line is in the hands of somebody that wants to run it, because forcing a carrier, a major carrier, to maintain service on a line that does not fit their system, that they do not want to run on, is an invitation to deferred maintenance.

It is far better to get that line into the hands of a regional carrier that really does want to run it and can make it work.

Senator PRESSLER. What about the issue of the secondary boycott? What effect, if any, might this have on regional and short line railroads and what should be done about if, if anything?

Mr. RILEY. Well, while it touches everybody I really think that it is going to have the greatest impact on regional railroads, and here is why. When the railroad industry was partially deregulated we recognized that there are different regional markets around the country and that railroads operating in areas with different demographics have got to have different costs and work rule procedures.

Secondary boycotting, which allows, to use the case in point, a dispute involving 150 employees in Maine to shut down the Nation, drives everybody back into national handling. It forces a single negotiation between the companies and the unions at the national level. And when you force that, the standards that are acceptable to the largest railroads inevitably dominate the negotiations.

I really believe that we will have more jobs and better systems if the major carriers can negotiate their deals, the regionals can negotiate their deals. I think Jack Haley, sitting behind me, is one of the best examples of the fact that if you have flexibility a smaller regional carrier can negotiate a deal that is different but perfectly acceptable to labor and the railroad. I think they need to have the flexibility to do that.

Secondary boycotts take it away, because if a strike on a small railroad can shut down the Nation, the carriers have to negotiate together and the negotiating stance will always be defined by the biggest carriers.

Senator PRESSLER. Senator Rockefeller.

Senator ROCKEFELLER. Thank you, Mr. Chairman.

Mr. Riley, you did not specifically in your testimony reflect on the Local Rail Service Assistance Act, so let me just ask you, in your view, should the Local Rail Service Assistance Program be continued?

Mr. RILEY. Well, Senator, I think that we have expressed our view in our budget recommendations, but let me elaborate on it so you understand where we are coming from.

I think the money that has been appropriated under the LRSA Program has in fact been well spent. In fact, we put $300,000 into the South Branch Valley Railroad and sent Lou Thompson and his strike force out there to help them with their technical analysis. And I think that was a real success story.

On the other hand, the budgetary crunch that we face forces us to look at our programs and decide where if we do not fund it, no one will, and where if we do not fund it, someone else is likely to and to draw distinctions between those two types of programs. There are now 22 States that have their own equivalent of the LRSA Program, and that is why it fell on the elimination side of the budgetary cut line, unlike some of the safety programs, where clearly if we do not fund them no one is going to do it.

The advantage of doing it on the State level is that it gets it out of the unpredictability of the Federal budget process, because while many States have budgetary problems, few are on the same level as the Federal Government's. Moreover, it enables—all of these lines run almost entirely within one State, and it enables the States to make their own priority decisions and administer those decisions without having to get people like Lou and myself involved.

So I guess the bottom line on it is the money has been well spent. There is no question about it. Twenty-two States have demonstrated the fact that they will in fact and can step in, and in many cases I would have to say I think they do a better job than we do because they are more closely in touch with the people who are really running those lines.

But when we have to make budget choices—and we are past the era when you can cut the budget by eliminating waste, fraud and abuse in our agency—you have got to choose between programs, all of which have some value. Our preference is to keep the ones that no one will step into if we do not fund, and when we have got to make a cut to make that cut in the area where others have demonstrated a willingness to get into it.

And that is really honestly the rationale behind what we have done.

Senator ROCKEFELLER. Well, I appreciate your response on that. I disagree with you on that. I agree with you that States will sometimes step in and help with certain aspects, but the very fact of abandonment by major railroads usually indicates that they have neglected those lines for a long period of time, and just as you indicated, in West Virginia the Local Rail Service Assistance Program was very helpful in that regard. I am not sure that the State could have gotten by without that program.

And you say that State budget deficits are less problematic than the Federal ones. That is not true in the case of some States, you know. In West Virginia our unemployment is double-digit. Our times are terrifically hard. We are going to have a shortfall of revenue which to us is going to be of greater magnitude than the problems that Gramm-Rudman faces.

But, you know, you are looking at Conrail which hopefully is going to be sold one of these days, and I hope by public offering. You have a lot of major carriers continuing to press for abandonment procedures. And it is one thing if somebody can come in and make a purchase of a railroad. It is quite another thing to upgrade the trackage after the deterioration, the bridges, the so-called rail infrastructure, more than just the purchase.

And to me the LRSA Program, the Local Rail Service Assistance Program, is absolutely fundamental there. Now you disagree on that, and I understand that. We have disagreements as between our points of view.

Let me ask you this. Requests for local rail assistance help to your agency, in what proportion were they last year in comparison to the money that you had available?

Mr. RILEY. Before I yield to Lou to give you the precise data on that, because he administers the program, what we have attempted to do, particularly given the small size of all of these lines, is rather than take two or three programs or four or five and fund them completely, to try to take as many of the worthy applications as we can and fund them partially, either so that we can be a lever toward the attraction of other investment or so that we can see many projects going over a period of years.

And what we have done, recognizing the fact that in my part of the country and in the Senator's part of the country we have a short construction season, what we have done is set up two periods for applications every year. We disperse part of the money in the early summer application series and then part in the fall. Against that background, Lou, why don't you provide the specific data.

Mr. THOMPSON. Senator, let me give you the exact numbers for fiscal year 1986. The 1985 numbers were essentially the same proportions. We have applications for discretionary LRSA grants from 20 States involving 23 projects, at about $23 million, and there is approximately $10 million available.

Mr. RILEY. We are in the process of sorting that out now. I want to have our grants out of here, if we can do it, by the end of this month.

Senator ROCKEFELLER. So you have more than twice as many money requests as you have funds.

Mr. Chairman, I recall very vividly yours and my efforts last year to keep this program from going to zero, and we had a lot of conferences on that and a lot of meetings with the chairman of this committee to try and save the program. I understand what Mr. Riley is saying about there not being any more fat, but if you take the South Branch Railroad out of West Virginia, out of that eastern part of the State, there are not any more industries in there. It is not a question of fat; there are no more jobs.

So I strongly support Local Rail Assistance for States like West Virginia and others, and I know, Mr. Chairman, that you and I will be two people fighting very hard for the continuance of that program. Thank you.

Senator **Pressler**. Thank you very much. I have some additional questions for the record which I will submit. I thank you.

[The following information was subsequently received for the record:]

Questions of Senator Pressler and the Answers

Question. In my statement I discussed the issue of financing for lines which would otherwise be in trouble. That is basically the function of Local Rail Service Assistance money. Has the LRSA Program been effective over the years?

Answer. The LRSA Program has been effective over the years in retaining rail service on lines which otherwise might be abandoned. The Program has also been effective in providing valuable lead-time for states to establish their own rail assistance programs. Currently, 22 states have their own independently financed rail assistance programs which can address these needs in the future.

Question. What effect does FELA have on small and regional operators?

Answer. The Federal Employers' Liability Act is an extremely expensive compensation program, one that places a significant burden on the economics of small, regional carriers.

The major carriers have argued that FELA is costly because of wide variation in damage awards, litigation costs, and the high proportion of judgments that go to contingency fees. The burden is proportionately greater on small and regional railroads which are exposed to the same potential liability but have limited resources across which to spread the costs. Although larger railroads are ale to self-insure for occupational risks, small railroads must purchase insurance. As insurance rates have risen, premiums have become a substantial component of small railroad costs.

Question. The secondary boycott issue is a big issue today. What affect, if any, might this have on regional and short line railroad expansion?

Answer. In the aftermath of deregulation this country is benefitting from a wide diversity of railroads serving the needs of shippers and consumers, from new short lines organized by shippers to large transportation companies such as CSX. In this environment of differing demographics and regional submarkets, railroads will need to adapt operating practices and work rules to meet the varying needs of their regional shipping communities, as well as the practical requirements of their varied scales of operation. If, through secondary activity, a local or regional dispute can be turned into a national issue, all carriers will inevitably be driven back into national handling, where the parameters of agreement are inevitably defined by the needs of the larger carriers. Small carriers—and their shippers—will inevitably suffer as flexibility for regional negotiation diminishes.

Question. I expressed concern over the need for a kind of benevolent relationship between the large and small railroads to make these divestitures work in the long run. The small railroads, particularly the smallest short lines, seem to be at the mercy of the big lines. In many cases, they exist at the pleasure of the Class I. Is there anything we can or should do to protect the small operators, or to ensure the long term viability and independence of the short line?

Answer. I believe that the economics of the transportation market, not regulation, will best guarantee a good working relationship between short line and Class I railroads. The viability of any railroad, large or small, can only be ensured by its continued ability to generate and carry traffic profitably. Because they exist primarily to provide local service, short line railroads will always be dependent on the Class I connections to provide long haul service for their shippers. However, the Class I must also rely on the short line's lower operating costs and marketing ability to retain freight the larger carrier cannot afford to originate or terminate. If the profitability of its smaller connections is jeopardized, the Class I risks losing a valuable part of its traffic base.

Senator **Pressler**. At this point we call on Hon. Heather Gradison, Chairman, Interstate Commerce Commission for her testimony, and we also should note that the former Chairman of the Commission is in the audience. Reese Taylor, will you stand up and take a bow?

You may proceed. Summarize your testimony, if you could, and give us the highlights and we will place your entire statement in the record.

STATEMENT OF HON. HEATHER GRADISON, CHAIRMAN, INTERSTATE COMMERCE COMMISSION, ACCOMPANIED BY DAN CAMPBELL, DEPUTY GENERAL COUNSEL

Ms. **Gradison**. Thank you, Mr. Chairman. It is good to be here. Senator Rockefeller, it is an honor to testify before you again as well.

Our prefiled statement discusses generally the conditions prevalent in the short line segment of the rail industry and the results of an informal survey of short line railroads conducted by the Commission's Office of Transportation Analysis. The statement also discusses various actions the Commission has taken to expedite the creation of short line railroads as well as the public assistance the Commission provides to potential and existing short line carriers.

In recent years, there has been significant growth in the number of short line railroads which have begun operations. In most cases the railroads are formed to take over abandoned lines or lines that are about to be abandoned, or lines which of major systems find to be unprofitable or marginally profitable.

The change in the regulatory environment which began with the 4R Act of 1976 and continued with the Staggers Rail Act in 1980 was instrumental in the development of short lines. Provisions of these acts made it easier for major carriers to abandon unprofitable lines and also provided the opportunity for shippers, States, and entrepreneurs to operate these same lines.

Another factor that has probably contributed to short line development has been the large number of mergers in the past 10 years. In many instances, parallel or little-used lines are abandonment candidates subsequent to mergers. Finally, State rail planning and financial support have assisted in the creation of some new short lines. The most significant aspect of short line operations is that they are providing a beneficial service to shippers in the local economy, more effectively and more profitably than could the trunk line carrier.

I would like to highlight labor relations, one important area of short line operations discussed in our statement. Virtually all carriers contacted in our surveys have indicated that labor productivity is critical to their prospects for success as replacement carriers. Generally speaking, relative productivity improvement over the class I experience is achieved from both lower pay scales and more flexible rules regarding work assignments.

To the extent one factor is more important than the other, flexibility in work assignment appears to be the critical component. For the smaller short lines, labor may frequently be part-time or performed by individuals who also act in a managerial or sales capacity. For the larger regional carriers labor relations are much more likely to be structured according to the standard craft divisions and, among the largest, unionization is more common than not. Where unionization exists, representational leadership may be the same as prior to the transfer of the lines. However, there are in all cases major differences between the standards for compensation or work rules, or both. Although wage rates may be below the national standard for a given craft, this is not always the case, and profit-sharing plans may exist as wage supplements. In all cases there are significant productivity-creating modifications in the rules and the working conditions that constitute the class I norm.

While the Commission considers the acquisitions on a case-by-case basis, it has adopted a general policy against the imposition of labor protection, unless required, in the formation of short line and regional replacement carriers under section 10901. It is the Commission's view that the development of replacement service has a beneficial effect on the provision of rail service and the prospect for rail employment as well.

There is good reason to believe that rail labor protection would retard the development of full replacement service and accelerate job loss in the industry. We are continuing to study the post-Staggers short line experience, including the impact on labor. We expect to have more concrete data which we would like to provide for the committee as well.

The Commission has taken several steps to expedite creation of short line carriers. In line with the mandate of the Rail Transportation Policy to reduce barriers to entry, we have removed numerous regulatory obstacles.

In January of 1986 we adopted expedited procedures to exempt most short line acquisitions and operations from prior approval requirements. Under this class exemption a new operator must file only a brief notice for publication in the Federal Register. The transaction can be consummated 7 days after the notice is filed.

The impetus of the class exemption was our recognition that short lines frequently need to complete a purchase rapidly to take advantage of favorable financing and to ensure uninterrupted service. It was also clear that the need to issue individual decisions in each case made it difficult to process these cases quickly enough. We reviewed our records of exemptions and applications and found that virtually all such requests were unopposed and were routinely granted. Finally, we found that there was usually widespread local business and government support for these proposals.

Other ICC regulations aimed at streamlining the regulatory process include adoption of a class exemption for the issuance of securities, adoption of a class exemption for certain acquisitions by short lines to exempt their operations, and ex parte No. 282—Sub No. 11—which was served just July 7 of this year and becomes effective on August 7, where the Commission expanded the class exemption to include the continuance in control of a connecting carrier.

Finally, the Commission recognizes that Congress has expressed special concern about joint rate cancellations that affect smaller short line railroads. Recently, we adopted special procedures in ex parte No. 445—Sub No. 1—that require a 45-day notice period and, upon demand of any connecting carrier, an explanation and justification of proposed joint rate or route cancellation prior to filing a proposal. This proceeding also sets forth the criteria under which the Commission would investigate cancellations and prescribe joint rates, through routes, and reciprocal switching.

In the public assistance area the Commission assists short line railroads in a number of ways. First, we publish booklets specifically directed to short line railroads. These booklets examine and define many economic, physical, and legal costs and considerations in starting up a railroad and also provide information on the ICC procedures for obtaining approval to operate a railroad.

This includes everything from acquisition or operation of existing lines and those proposed to be discontinued or abandoned to the actual construction of new lines. The booklets emphasize, however, that compliance with ICC requirements is only one, and probably the easiest, aspect of starting a short line railroad. There are so many other nonregulatory issues to be considered that we want to emphasize to those making application the burden that they are taking on.

In addition, the Commission's Office of Public Assistance responds on a routine basis to inquiries on matters of interest to short line carriers, both through questions in person and questions in writing. The inquiries address such issues as application and exemption procedures, as well as information on which lines may be abandoned or what the status of an abandonment application may be.

In summary, the Commission believes that short line railroads play a key role in the preservation and enhancement of rail service. We are committed to easing unnecessary regulatory constraints in order to facilitate transactions and are cognizant of our role of properly balancing the provisions of the national transportation policy in our decisions.

Thank you.

Senator **Pressler**. Thank you very much for your testimony.

Let me ask you if the law were amended to require the ICC to impose labor protection in sales transactions, what impact would this have on such transactions and on rail employment? What is your view of this general matter?

Ms. **Gradison**. We would hope that such a law would not be enacted. Those decisions are clearly up to you, the Congress, and we can provide guidance and thoughts, and if such a statute were to be put into place we feel that these transactions probably would not take place.

Senator **Pressler**. If the law were amended to require the ICC to impose labor protection in sales transactions, what impact do you think that will have?

Ms. **Gradison**. We do not think these transactions would take place.

Senator **Pressler**. You do not think they would take place. All right. And why is that?

Ms. **Gradison**. The transfer of the lines generally to nonrail carriers takes place in order for the lines to provide economic efficiencies in operations that the major carriers are not able to provide. If they are required to maintain the existing standards, the efficiencies are not there for a short line carrier to then take over the line.

Senator **Pressler**. Could you comment on the rationale for the railroad/nonrailroad distinction in invoking labor protection?

Ms. **Gradison**. The law requires that we provide for labor protection when a transfer is made to another carrier. When the transfer is made to a noncarrier, it is at the Commission's discretion. Let me say that we look at each one of these on an individual basis. We do have a Commission policy to provide for this exemption, and we do exercise our discretion in not imposing labor protection in most instances.

Senator PRESSLER. Well, should we change the law?

Ms. GRADISON. No, sir.

Senator PRESSLER. We should not? Then you are opposed. I think over in the House there are some stirrings around on the labor protection issue.

Ms. GRADISON. It would put an end to the short line experience. It would put an end to the creation of new short line carriers.

Senator PRESSLER. But should we change the law regarding the railroad/nonrailroad distinction in invoking labor protection?

Ms. GRADISON. I am sorry. Could you repeat the question?

Senator PRESSLER. Should we change the law regarding railroad/nonrailroad distinction in invoking labor protection?

Ms. GRADISON. The Commission has not voted on this matter. If you were to change it to allow a railroad to sell it to another railroad and not require labor protection, perhaps that would be an improvement on the existing standard.

Senator PRESSLER. That is what I am getting at, and I would like to maybe submit for the record more. I have never quite understood the rationale for the railroad/nonrailroad distinction.

Ms. GRADISON. Excuse me. Let me allow Deputy General Counsel Dan Campbell to respond more completely to this.

Senator PRESSLER. Because I think this labor thing is important to get into a little bit.

Mr. CAMPBELL. The distinction that is in the law presently, arose out of the fact that in merger and acquisition proceedings, generally there is a combination of facilities and the likelihood of redundant labor force is much higher than it would be in the acquisition of a new line. So consequently it is presently mandatory in the statute for the Commission to impose some degree of labor protection where the consolidation of two operating carriers is at stake. It is also mandatory in the Interstate Commerce Act to impose labor protection where an abandonment goes forward.

Senator PRESSLER. Well, should Congress change that so that is not mandatory. You are describing the law. Let me get your recommendation here as to what we need to make this work better.

Mr. CAMPBELL. The direct issue of whether or not—well, maybe I have to ask you a question, Senator. If the question is should the Interstate Commerce Act now permit the acquisition of multiple short lines by the same controlling corporation without the imposition of labor protection, I think the issues that Congress needs to deal with are the same that exist in section 11343 itself, the merger provision itself, which is whether or not the combination that we are looking at is likely to involve significant integration in labor force, the possibility of redundancy and thereby the possibility of labor strife.

If the answer that you reach as the legislature is that that is not the case and you want to cut out some particular exception from section 11347, the provision that requires labor protection, I think that that can probably be done. But I think that you will be taking on quite a battle there because the fact of mandatory labor protection is something that the labor interests look to with a great deal of regard.

In fact, as I understand what is going on in the House, the movement was in the opposite direction. There was an argument that lack of mandatory labor protection in section 10901, the section that governs the sale of lines to noncarriers, is under debate. The Commission feels very strongly that it needs to maintain its discretion under section 10901.

And at least I believe I am hearing from the Senator that he feels the same about that, that if discretion under section 10901 is removed——

Senator **Pressler**. But does it make sense to impose that on the smaller lines?

Mr. **Campbell**. No; in the hypothetical that I just drew in which there is no redundancy between labor force and no likelihood of integration. The answer is "no."

Senator **Pressler**. My time is up.

Senator **Rockefeller**. Chairman Gradison, we have a sudden and major crisis in the State capital of West Virginia, and that is the abandonment or the hoped-for abandonment by the Chessie System of a major railroad bridge. We have had a fairly bad experience with the Chessie System in our State capital of Charleston, WV. They have abandoned a train depot, they have abandoned a street ramp, and have not been cooperative.

But this latest attempt at abandonment which stands in your hands is a real body blow to the economy of the State capital of West Virginia, a State which is reeling economically in any event. The railroad bridge is across the Kanawha River. It was damaged last December by a derailment. The railroad first tried to take advantage of a Federal exemption and dump the bridge in a hurry-up fashion before any public complaints could grow or be heard.

A Federal court struck that down, struck down the attempt of the Chessie System to do that. Chessie therefore has been forced to file with you, Chairman Gradison, a request to discontinue the use of this bridge. Well, let me just tell you that this is not just another railroad bridge. This bridge is used every day by major chemical corporations, which is the heart and soul of the economy of the State capital, the FMC Corp., the Monsanto Corp., Union Carbide Corp., who are saying that their delivery time is going to be increased by 1 to 2 days if this abandonment is allowed by the Interstate Commerce Commission.

I think it is a dangerous situation for our State capital, for the State of West Virginia, and I think it is an arrogant action on the part of the Chessie System.

Now time is running on the comment process. The people of West Virginia are angry. The Governor's office has been meeting on this. The office of economic and community development within the Governor's office has been meeting. The Kanawha County Commission, the West Virginia Railroad Maintenance Authority, the people are up in arms about this particular potential abandonment because it means so much to the State capital.

Time is running for the comment period and for the process. I want to ask you, Chairman Gradison, if you would be willing to hold a public hearing on what is a massively important economic crisis facing our State capital and the area around it, if you would be willing to hold a public hearing to hear out some of the specifics of this potential economic disaster, if either you or some of your Commission members or some of your staff would come to Charleston, WV and hold a public hearing.

I kid you not when I say that this is a major economic crisis for a chemical industry which is in trouble.

Ms. **GRADISON**. Yes sir.

Senator **ROCKEFELLER**. You will be there. I applaud you.

Ms. **GRADISON**. We will find a way to take comments, and if I cannot be there personally we will make sure that we have Commission staff there to investigate what the problems are. I do not know what is involved in a public hearing, but I will certainly send Commission staff or myself to find out more about the problem and see what we can do to facilitate the parties working together to come to a solution.

Senator **ROCKEFELLER**. Madam Chairman, I think that is first class and I appreciate it, and it means a great deal in continuing the possibility of working out this severe potential financial crisis, and I thank you.

Ms. **GRADISON**. That is one of the roles that our Commission can play and we can be a facilitator and we are happy to do what we can.

Senator **ROCKEFELLER**. Thank you. Thank you, Mr. Chairman.

Senator **PRESSLER**. Thank you.

[The statement follows:]

STATEMENT OF HON. HEATHER J. GRADISON, CHAIRMAN, INTERSTATE COMMERCE COMMISSION

Mr. Chairman and members of the subcommittee; thank you for the opportunity to present the views of the Interstate Commerce Commission on this matter. I will first discuss generally the conditions prevalent in the short line segment of the railroad industry, and share with you the results of an informal survey conducted by the Commission's Office of Transportation Analysis [OTA]. I will then discuss various actions the Commission has taken to expedite the creation of short line railroads, as well as the public assistance the Commission provides to potential and existing short line carriers.

BACKGROUND

In recent years, there has been significant growth in the number of small railroads which have begun operations. In most cases, these railroads are formed to take over abandoned lines, those lines about to be abandoned, or lines which major systems find unprofitable or marginally profitable. Although the impetus for the growth in short line railroads is not totally clear, certainly the change in the regulatory environment which began with the Railraod Revitalization and Regulatory Reform Act of 1976 and continued with the Staggers Rail Act in 1980 was instrumental in the development of short lines. Provisions in these Acts made it easier for major carriers to abandon unprofitable lines, and also provided the opportunity for shippers, States, or enterpreneurs to operate these same lines. Another factor that has probably contributed to short line development has been the large number of mergers in the past 10 years. In many instances, parrallel or little used lines are abandonment candidates subsequent to mergers. Finally, State rail planning and financial support have assisted in the creation of some new short lines. The most significant aspect of short line operations is that they are filling a transportation need more effectively and more profitably than could the trunk line carrier. In general, they have found a niche in the market and are filling a void in a way that is generally profitable for them, as well as beneficial to shippers and the local economy.

DATA BASE

In order to develop information on new short lines, OTA contacted 157 class III railroads. The information that follows is based on the responses of 131 of these short lines to a brief questionnaire (copy attached). The questionnaire was intended to provide a summary of the characteristics of existing short line operations and to address the relationships they have with larger carriers, as well as an assessment of their long term prospects. It should be noted that since only those railroads which are currently in business were contacted, the results are likely to be positively biased. However, we believe the responses do provide a useful and current profile of new short line operations.

PROFILE OF NEW SHORT LINE RAILROADS INCLUDED IN THE SURVEY[1]

The table below indicates the year in which the short lines contacted were established. The growth in new short line railroads has been fairly stable since 1982, with twenty or more railraods beginning operations each year from 1982 to 1986.

YEAR ESTABLISHED

	Number	Percentage of total
1981	13	10.3
1982	22	17.3
1983	21	16.5
1984	26	20.5
1985	23	18.1
1986	22	17.3
Total	127	100

The 127 railroads surveyed operated a total of 4,679 miles of line. (Approximately 2.5 percent of total railroad mileage operated in 1985.) Of the short lines contacted, 48 percent were 25 miles or less in length, with the shortest line 1 mile long and the longest 169 miles. A total of 953 individuals were employed by these railroads. A few of the short lines used part time or temporary employees. Only ten of the short lines had union employees. Of the total work force, 105 (approximately 11 percent) were union members. In nine out of the ten situations where a union was present, the railroad had negotiated concessions from the union. These included: lower wage rates, two man crews, cross craft assignments, and the elimination of cabooses.

DISTRIBUTION OF SURVEYED SHORT LINES BY MILEAGE

Length of line (miles)	Number of railroads	Percentage of railroads	Total miles	Percentage of total miles
1 to 5	21	16.5	51	1.1
6 to 10	17	13.4	151	3.2
11 to 25	23	18.1	368	7.8
26 to 50	34	26.8	1,177	25.2
51 to 75	9	7.1	555	11.9
76 to 100	12	9.4	1,034	22.1
Over 100	10	7.9	1,343	28.7
Total	[1] 126	[1] 99.2	4,679	100

[1] One railroad did not provide mileage.

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[1] This section does not include the Gulf & Mississippi Railroad Corp., Iowa Interstate Railroad Ltd., Midsouth Rail Corp. or the Chicago, Central & Pacific Railroad Co. These are discussed separately.

GEOGRAPHIC SCOPE OF OPERATIONS

The short lines contacted serve 34 States, with the heaviest concentration in the northeast and south. States with the largest number of short lines interviewed were: Pennsylvania, 18; Ohio, 10; Mississippi, 8; New York, 7; Iowa, 7; Tennessee, 7; Illinois, 7.

TRAFFIC

A total of 297,287 carloads of traffic are handled by these short lines each year. The mean volume is approximately 2,700 cars. Fifty percent of the short lines haul under 900 carloads per year. Volume of traffic ranged from a low of 50 carloads per year to a high of 19,000. Although a wide range of goods are transported by short lines, they predominantly haul bulk commodities. The major commodities listed by respondents were as follows:

Commodity:	*Respondents*
Lumber and lumber products	47
Agricultural products including grain and grain products	35
Fertilizer	20
Paper and paper products	18
Plastics	17
Coal	16
Scrap metal	14
Chemicals	12
Steel and steel products	10

RELATIONSHIPS WITH LARGE CARRIERS

In order to assess the relationships between the short line and the large railroad, OTA asked the respondents to describe their interaction with connecting carriers. Only 5 of the 127 questioned said that the relationship was poor. Thirty-five respondents indicated that the relationship was excellent to good, and, likewise, 30 described the relationship as fair. Forty of the carriers contacted simply described their operational relationship with connecting carriers without comment on the quality of this relationship. Seventeen did not comment. Many of the respondents reported that the connecting carrier was highly cooperative and provided numerous essential services, such as furnishing cars or special equipment; joint marketing efforts; billing, collection and revenue accounting services; and car accounts and car tracing.

OTA also sought information on how divisions were established and whether this was a problem area. Many lines (36) reported that divisions were established by contract or through negotiation. Switching roads simply responded that they were paid a switch fee directly (19). Five respondents indicated that they were able to establish their own proportional rates on some commodities. Three short lines indicated that they used historical divisions subsequent to the creation of the new line. Only six of the respondents indicated that this was a problem area. Of the six, three felt that rates were not competitive or wanted higher divisions, two indicated that they had difficulty in negotiating divisions on new traffic, and one complained about delays in receiving payment from the connecting carrier.

One plausible explanation for the lack of problems with divisions is the fact that most of the short lines know their divisions prior to beginning operations. This is covered in the overall negotiations for the line. Therefore, they are less likely to be dissatisfied with the division arrangement. If they are dissatisfied with the arrangement offered, they simply do not acquire the line.

PROSPECTS FOT THE FUTURE

The vast majority of short lines believe that future prospects are positive (85). Two respondents were neutral. Fifteen (or 12 percent) had a negative assessment of their future. Those that were successful attributed their successs to a variety of factors. The most significant factor was the development of new business (33) followed closely by labor efficiency and labor cost considerations (20). To a lesser extent, they indicated that effective marketing, services tailored to the needs of the shippers or stable traffic patterns had a positive impact on their assesment of the future.

Six of the lines that were pessimistic about their future attributed their problems to a lack of traffic, a decline in traffic, or that anticipated traffic did not materialize. Other factors mentioned included: insurance problems (3); truck competition (2); poor relations with larger carriers (1); expense of maintaining the right-of-way (1);

the failure of local government to purchase a leased line (1); being captive to a single connecting carrier (1).

REGIONAL RAILROADS

In addition to the 127 short lines contacted, OTA interviewed four other railroads which did not appear to be typical short line operations. These might be thought of as regional railroads. They are the Gulf and Mississippi Railroad Corporation, Iowa Interstate Railroad, Ltd., Midsouth Rail Corporation, and Chicago, Central and Pacific Railroad Company. Those lines are much larger in size and geographic scope of operations than most short lines. They operate between 416 and 772 miles of track, employing between 140 and 536 employees. As might be expected, volume of traffic of these four railroads is much greater than the average short line, with between 20,000 and 100,000 carloads hauled per year. Also, while they all handle bulk traffic, such as coal, lumber, and farm products, they also handled manufactured goods either in boxcars or trailers-on-flatcars.

All four of these regional carriers were optimistic about their future, mentioning location, good connections, favorable labor situations, effective marketing, tailored services and lower rates as the primary reasons for their optimism. None indicated any difficulty in dealing with connecting carriers.

LABOR RELATIONS

Virtually all carriers contacted have indicated that labor productivity is critical to their prospects for success as replacement carriers. Generally speaking, relative productivity improvement over the Class I experience is achieved from both lower pay scales and more flexible rules regarding work assignments. To the extent one factor is more important than the other, flexibility in work assignment appears to be the crucial component. For the smaller shortlines, labor may frequently be part-time or performed by individuals who also act in a managerial or sales capacity. For the larger regional carrier, labor relations are much more likely to be structured according to standard craft divisions, and among the largest, unionization is more common than not. Where unionization exists, representational leadership may be the same as prior to the transfer of lines. However, there are in all cases major differences between standards for compensation or work rules, or both. Although wage rates may be below the national standard for a given craft this is not always the case, and profit sharing plans may exist as wage supplements. In all cases there are significant productivity creating modifications from the rules and working conditions that constitute the Class I norm.

The Commission has adopted a general policy against the imposition of labor protection in the formation of short line and regional replacement carriers. It is the Commission's view that the development of replacement service has a beneficial effect on the provision of rail service and the prospect for rail employment as well. There is good reason to believe that labor protection would retard the development of replacement service and accelerate job loss in the industry. Nevertheless, the Commission's policies have been challenged by labor. While the ICC has largely been upheld in the courts, we are continuing to study the post-Staggers shortline experience, including the impact on labor. We expect to have more concrete data in the near future. Our preliminary understanding is that there is a high percentage of "re-hires" (employment of individuals formerly employed by the departing carrier) among the larger regional lines, and that employee morale on the new lines is quite good. We will forward the results of our continuing study when they become available.

GENERAL OBSERVATIONS

While there is no precise way to categorize every short line that started up after Staggers, below are some observations based on insights gained from OTA's informal survey of short line railroads:

All of the respondents started up by taking over some track abandoned by a major carrier. This was usually done in settlement with the bigger carrier during the abandonment process, but not always so (e.g., Vandalia Railroad Co. took over, in 1984, 2½ miles of track abandoned in 1981).

The track typically needed some rehabilitation work, and often the State, local government, FRA, or shippers shared in this expense.

Almost all short lines are non-union with 2 man crews, flexible work rules, and cross craft flexibility in making work assignments.

The very small short lines are typically not large enough to have full time employees. There are usually only a few (10 or less) miles of track, and at most a handful of shippers. This type of railroad is typically run by one or a consortium of shippers, with rail employees splitting time between the railroad and shipper(s) (e.g., Vandalia Railroad Co. and Turtle Creek Industrial Railroad, Inc.).

As short lines get larger, the type of operators vary significantly. Some are started by shippers that hire outside companies to come in and manage short lines (e.g., Kyle Railways manages Saint Maries River Railroad for the major shipper/owner, Potlatch Corp., and Tennken Railroad and West Tennessee Railroad Corporation are both run by a company that came in after local governments and shippers bought abandoned track). Other short lines are started by private investors with some help and encouragement from shippers (e.g., Texas North Western Railway Company).

Just about all short lines operate as low cost feeder and distribution systems in connection with larger railroads.

In general, the short line represents business that the big railroad could not profitably retain or attract. The big railroad and short line complement one another's operations.

In general, short lines started up after 1980 are in the freight railroad business, not the rail car leasing business.

In sum, it appears that factors that are pivotal to the success of short line operations are a stable or growing traffic base, lower labor costs and greater labor productivity.

COMMISSION ACTIONS

The Commission has taken several steps to expedite the creation of short line railroads. We recognized that fundamental changes in the rail industry had resulted from Class I carriers selling uprofitable or marginally profitable lines to short line railroads. In line with the mandate of the rail transportation policy to reduce barriers to entry, we have removed numerous regulatory obstacles which could otherwise impede the smooth transfer of these operations.

In January, 1986, we adopted the new, expedited procedures now codified at 49 C.F.R. 1150.31. These procedures exempt most short line acquisitions and operations from the prior approval requirement of 49 U.S.C. 10901. Under this class exemption, a new operator must file only a brief notice for publication in the Federal Register. The transaction can be consummated 7 days after the notice is filed.

The impetus to the class exemption was our recognition that short lines frequently need to complete a purchase rapidy to take advantage of favorable financing and to assure uninterrupted service. It was also clear that the need to issue individual decisions on each case made it difficult to process these cases quickly enough. We reviewed our records of exemptions and applications and found that virtually all such requests were unopposed and were routinely granted. We also found that much of the information required by our former procedures was not needed, since these proceedings usually involved continuation of unprofitable or marginally profitable lines, which, in all probability, would have been abandoned by the Class I carrier. Finally, we found that there was usually widespread local business and government support of these proposals.

The new procedures have been in effect for 3 months, and 12 notices have been filed under them. The only opposition has been from labor, seeking employee protective conditions.

Other regulations aimed at streamlining the regulatory process are:

(a) 49 CFR 1175, a class exemption for the issuance of securities. Under this regulation, short lines need not file for ICC regulatory approval of securities issuances connected with the transaction.

(b) 49 CFR 1180.2(d)(1) and (2), a class exemption from the prior approval requirement of 49 U.S.C. 11343 for certain acquisitions by short lines to expand their operations. Short lines must file a notice, and the proposal can be consummated 7 days later.

(c) Ex Parte No. 282 (Sub-No. 11), served July 7, 1986, to be effective on August 7, 1986, where the Commission voted to expand the class exemption at 49 CFR 1180.2(d)(2) to include the continuance in control of a nonconnecting carrier.

The Commission has also granted individual requests by short lines to be exempt from all ICC regulation. There have only been a few such requests.

Finally, the Commission recognizes that Congress has expressed special concern about joint rate cancellations that affect smaller short line railroads. Recently, we adopted special procedures in Ex Parte No. 445 (Sub-No. 1) that require a 45-day notice period and, upon demand of any connecting carrier, an explanation and justification of a proposed joint rate or route cancellation, prior to filing a proposal. Ex Parte No. 445 (Sub-No. 1) also sets forth the criteria under which the Commission would investigate cancellations and prescribe joint rates, through routes, and reciprocal switching.

PUBLIC ASSISTANCE

The Commission assists both prospective short line railroad operators and existing short line railroads in a number of ways. First, we have published two booklets [2] specifically directed to short line railroads. These booklets, which we are in the process of consolidating, examine and define the many economic, physical, and legal costs and considerations in starting up a railroad. They also provide information on the ICC procedures for obtaining approval to operate a railroad, including everything from acquisition or operation of existing lines and those proposed to be discontinued or abandoned, to construction of new lines.

The consolidated booklet will reinforce what is already stated succinctly in both existing booklets—that compliance with ICC requirements is only one, and perhaps the easiest, aspect of starting a short line railroad. It will emphasize that there are numerous nonregulatory issues to be considered and assessed in the early planning stages. Our booklets stress that professional assistance in these areas is invaluable in insuring a successful operation.

Aside from making our booklets available to all interested parties, the Commission responds on a routine basis to oral and written inquiries on matters of interest to short lines. These inquiries address such issues as application and exemption procedures, as well as information on lines to be abandoned.

The Commission has been assisting existing short lines in another area, the acquisition and operation of motor carriers and motor carrier authority. Since the Commission has removed the barriers to cross ownership and unrestricted operation of motor carriers, small railroads, as well as larger ones, may own and operate motor carriers. In certain circumstances this intermodalism may make short line operations more viable or may otherwise independently aid the financial health of a small rail carrier. Staff of the Public Assistance Office have helped several short line railroads obtain such motor carrier authority.

Finally, the Commission conveys information, maintains a dialogue, and considers the views of short line railroads in other contexts. Our Public Assistance Office acts as the Commission's "ear" to the concerns of the small carriers. It has surveyed short lines to ascertain the problems and concerns of most interest to them and presented the views of short line railroads to the Commission.

Commissioner Lamboley, commenting:

I have joined in the Commission's efforts to encourage and assist developing short line railroads. I do, however, continue to question the Commission's general policy against the imposition of labor protection in the formation of short line and regional replacement carriers under 49 U.S.C. Section 10901.[3]

Likewise, I have concerns that the study conclusions reached by the Commission's Office of Transportation Analysis are premised on an insufficient data base. I would have preferred the survey to include not only existing short lines, but also some analysis to determine how many short lines authorized by the Commission actually became and/or remained viable operations.

More particularly, the study indicates no contact with any representatives of rail labor, nor does it address the question of the impact that short line railroads have had on employment levels or loss of employment.

For these and other reasons, the study conclusions regarding labor relations may not be warranted.

Senator **Pressler**. At this point we will call forward the short line and regional railroad panel: Mr. Ed Hurley, manager, Railroad Venture Team, L.B. Foster, Pittsburgh, PA; Mr. John E. Haley, president, Chicago, Central & Pacific Railroad Co., Waterloo, IA; Mr. Larry McCaffrey, Weiner, McCaffrey, Brodsky & Kaplan; Mr. H. Leroy Weidner, vice president, Allegheny Railroad.

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[2] "Guidelines for Evaluating the Feasibility of Short Line Operations" and "So You Want to Start a Small Railroad."

[3] See my separate expressions in Ex Parte No. 392 (Sub-No. 1), *Class Exemption for the Acquisition and Operation of Rail Lines Under 49 U.S.C. 10901,* served January 15, 1986; Finance Docket No. 30764, *Arkansas and Missouri Railroad Company, Et Al. Exemption From 49 U.S.C. 10901, 11301, 11322, and 11343,* served July 17, 1986; Finance Docket No. 30779, *Rochester and Southern Railroad, Inc., and Genesee and Wyoming Industries, Inc.—Exemption From 49 U.S.C. 10901, 11301, and 11343,* served July 13, 1986; Finance Docket No. 30628, *Lackawanna County Railroad Authority, Inc.—Exemption From Regulation,* served February 11, 1986.

Mr. Hurley is involved in the process of purchasing a railroad in South Dakota. We will start off with him, unless there is an objection.

STATEMENTS OF EDWARD L. HURLEY, MANAGER, RAILROAD SERVICES VENTURE TEAM, L.B. FOSTER; JOHN E. HALEY, PRESIDENT, CHICAGO, CENTRAL AND PACIFIC RAILROAD CO.; LARRY McCAFFREY, ON BEHALF OF PETE CLAUSSEN, PRESIDENT, MISSISSIPPI DELTA RAILROAD, AND ALABAMA & FLORIDA RAILROAD; AND H. LEROY WEIDNER, VICE PRESIDENT, ALLEGHENY RAILROAD

Mr. HURLEY. Good morning, Senators. My name is Edward L. Hurley and I am manager of the Railroad Management Services Railroad Venture Team of L.B. Foster Co. I appreciate the opportunity to appear here today to discuss the subject of regional railroads.

Foster has been in the business of providing material and services to the railroad industry for over 80 years. We closely follow developments in the industry and we are especially aware of the important reforms Congress adopted in the Staggers Act. As we watched major railroads begin to rationalize their plants in response to these reforms we became convinced that it would be possible to create profitable new independent railroads out of a combination of some of the lines the class I railroads wanted to cut from their systems and other associated higher density track segments.

So far we have gone forward with two regional railroads. The first was the Gulf & Mississippi Railroad, formed from more than 700 miles of former Illinois Central Gulf lines. We put the package together, obtained the regulatory approvals, and then sold the controlling interest to a group of unrelated investors. We remain a minority shareholder and provide G&M's management with consulting services and advice.

We are currently involved in the creation of the Dakota, Minnesota & Eastern Railroad from some 900 miles of lines owned by the Chicago & North Western Transportation Co., in South Dakota, North Dakota and Minnesota. We expect that the negotiations and regulatory reviews will be completed soon so that the DM&E can begin operations this summer. We plan to have the ownership of the DM&E structured along the same lines ultimately used for the G&M.

I would like to turn now to what we view as the critical elements for successful development of a new regional railroad. A new railroad is strictly a business proposition in which there is no room for sentimentality. To be successful, the economics of a particular project have to permit continued and improved service to shippers while at the same time providing an adequate return to investors.

The first critical element is an accurate economic evaluation of the prospects of a proposed regional railroad. This is not a simple matter. There is no such thing as an audited financial statement for part of an existing railroad. The economic evaluation has to be based on a knowledgeable examination of the lines, their current physical condition, the traffic they carry, the opportunities for reducing costs, and the potential for attracting additional traffic.

The second critical element is to develop a highly efficient organizational structure by having a small management staff operating from offices on the line itself. A regional railroad can and must eliminate substantial overhead costs. This sounds far easier than it is, for the new, lean management must include the same broad range of skills that a major railroad supplies through its headquarters staff.

The third critical element is to refocus marketing activities to generate the maximum possible traffic from shippers on the line by providing individualized attention for all of its potential shippers and by making creative use of the pricing freedoms provided by the Staggers Act. A regional railroad can often generate more traffic from a line than the class I railroad had been able to attract.

The fourth critical element is the ability to employ the work force more effectively by establishing more flexible work rules than those permitted by the national labor agreements. A new railroad can make broader use of its employees' skills and significantly reduce its overall labor costs. Even more important, the new railroad also provides an opportunity to give employees a real stake in the business through a profit sharing or an employee stock ownership plan.

The final critical element is a firm financial foundation which will permit both ongoing operations and future growth.

With these critical elements in mind, I would like to turn to the question of what the Federal Government can do to encourage the growth of the regional railroad industry.

First, and most important, it is essential to preserve the reforms of the Staggers Act and to let market forces rather than regulation govern the activities of new carriers, especially with respect to rate flexibility. It is also vital to preserve the reduction in regulatory delay brought about by the ICC's recent *class exemption* decision, which makes it possible to obtain regulatory clearance for a new railroad in 7 days.

Second, there is a need for some means to help new regional railroads cope with the current liability insurance crisis. The high cost of liability insurance and the cost of maintaining a substantial reserve for self-insurance retention are major expenses. These costs are magnified by the fact that the reserves are nondeductible. Where the economics of a project are on the borderline, these added costs could make the difference between a project that is attractive to investors and one that is not.

In addition, difficulties in obtaining adequate officers' and directors' liability insurance has a direct impact on a new railroad's ability to obtain the caliber of management it needs to make the railroad a success.

Third, there is a need for amendment of outmoded railroad laws, such as the Federal Employers' Liability Act. Unlike worker's compensation statutes, which apply to most other industries, FELA makes onduty injuries of railroad workers the subject of personal injury suits. These suits are tied to a jury with no limits on damages, under legal standards which are extremely unfavorable to the railroad.

Statutes such as FELA expose a new regional railroad to potential liabilities not faced by new companies in other industries and represent a disincentive to potential investors.

I hope these brief remarks have been helpful to you. I appreciate the opportunity to be here and would be happy to answer any questions you might have.

[The statement and questions and answers follow:]

STATEMENT OF EDWARD L. HURLEY, L.B. FOSTER CO.

Good morning, Senators. My name is Edward L. Hurley, and I am Manager of the Railroad Management Services Venture Team of L.B. Foster Company. I am appearing here today to describe Foster's activities in the field of regional railroads, and in particular to share with you our perspective on what is required to develop regional railroad systems that can not only preserve but improve rail service while at the same time offering attractive opportunities for investors. I appreciate the Subcommittee's invitation to participate in this panel, and I hope my comments will be helpful in formulating federal policies that facilitate regional rail development.

L.B. FOSTER'S RAIL VENTURE PROGRAM

I should begin by giving you some brief background on how L.B. Foster, which neither owns nor operates any railroads, became involved in the development of regional railroad systems. For over eighty years, Foster has been in the business of providing material and services to the railroad industry, working with both large and small railroads as well as shipper-owned facilities. As part of those services, we have a great deal of experience in advising users of rail products how to establish cost-effective programs to maintain, rehabilitate and upgrade rail lines.

Foster therefore has always had an interest in seeing that the nation's railroad network remained extensive and economically healthy. We obviously would like that network to grow, rather than contract. In recent years, however, there have been a number of factors pushing the rail industry toward contraction of individual systems rather than growth. As the Subcommittee is well aware, deregulation has brought about enormous changes in the economics of all transportation industries, and those changes have led to a number of important trends for the nation's major railroads. As the Interstate Commerce Commission and the railroads have implemented the important reforms Congress adopted in the Staggers Act, the major railroads have sought to rationalize their plants, much as would any unregulated business in reaction to economic changes. This has meant that routes offering relatively less attractive returns under the conditions in which the major railroads operate have become less important portions of their systems. In addition, there have been a number of mergers among major railroads, and in some instances those consolidations have rendered certain portions of a merged system less important to its overall operations.

These less important segments may face the prospect of eventual abandonment, or operation on at best a marginal basis. The obvious end result would be a contraction of the nation's total rail mileage and a substantial decline in rail service.

Foster, as well as others, could not accept those results as inevitable. Based on years of familiarity with the railroad industry, we sought to identify major lines that were relatively unattractive for their current Class I railroad owners, but that could be operated more economically—and more profitably—on an independent basis. Now, I want to emphasize that we do not view regional railroads as simply a convenient place to park unwanted segments of the major railroad systems. To the contrary, we would not have any interest in a proposed new railroad that consisted solely of low-density, low-return lines. In most instances, a major railroad must be willing to sell both unprofitable segments and profitable segments which, when taken together, form a package that is capable of standing alone and yielding adequate returns for investors. In any case, to be attractive to Foster, a proposed regional railroad must offer a substantial potential for increasing traffic—and returns—over those the seller has been able to generate.

Foster began in 1980, after passage of the Staggers Rail Act of 1980, to review our role and our participation in the railroad industry. In 1982 we started to study lines that might be developed into efficient regional railroads. While we have examined a number of potential projects, to date we have found only two of them to be economically attractive to us.

In 1984 and 1985, Foster oversaw the creation of the Gulf and Mississippi Railroad. The G&M was formed from more than 700 miles of former Illinois Central Gulf lines located in eastern Mississippi, western Alabama and southern Tennessee. Foster put the package together, negotiating the purchase of the lines, obtaining the necessary regulatory approvals, and reaching accords with unions representing the new railroad's employees. When the purchase was consummated and the G&M began operation in July 1985, Foster sold a controlling interest to a group of unrelated investors, who now control the new railroad. We remain a minority shareholder in the G&M, and provide its management with advice on maintenance, rehabilitation projects, and other management matters.

Foster is currently involved in the creation of another new railroad, the Dakota, Minnesota and Eastern, from some 870 miles of lines in South Dakota, North Dakota and Minnesota currently owned by the Chicago and North Western Transportation Company. It is our hope that the negotiations and regulatory reviews will be completed soon, so that the D,M&E can begin operation this summer. We plan to have the ownership of the D,M&E structured along the same lines ultimately used for the G&M, with a majority of the new railroad's stock being sold to third-party investors, who will control the company, and with Foster retaining a minority equity position.

As the development of these new railroads has progressed, the Railroad Venture Team has acquired substantial expertise in providing innovative marketing and service concepts, establishing an organization structure, and obtaining necessary financial support.

CRITICAL ELEMENTS FOR A REGIONAL RAILROAD

With this background, I would like to turn to what we view as the critical elements for successful development of a new regional railroad. Many people speak, with some justification, of the romance of the railroads. I hope don't sound unromantic when I say that the formation of a regional railroad is a business proposition, pure and simple. The process of creating a new railroad requires careful and often difficult economic evaluation, in which there is not room for sentimentality. What we are talking about is determining whether the economics of any particular project will permit continued—and improved—service to shippers while at the same time justifying the investment.

Obviously each potential investors has its own criteria for what constitutes an economically attractive project. In terms of the projects Foster has considered, an attractive candidate for a regional railroad would be one projected to generate annual revenues between $20 million and $100 million which, in addition, has the potential for significant added traffic or increased profitability. In other words, it would be neither a "short line" serving only a small number of shippers, nor a major trunkline, such as the so-called "Class I" railroads.

The first critical element is thus an economic evaluation of the prospects of a proposed regional railroad. THe historic performance of the lines in question must be analyzed and projections must be made regarding their potential profitability as part of a new regional railroad. Because the purchase inevitably involves only part of an existing rail system rather than the acquisition of an entire entity, there is no reliable financial history such as audited financial statements. Instead, a detailed examination of the lines—their current physical condition, the traffic they carry, the way in which they have been operated, and the potential for attracting additional shipers—must be scrutinized in detail. Most important, this analysis must have the credibility to be accepted by potential investors and lenders. Based on our years of experience in the rail industry, and in particular our expertise in the valuation of existing rail asserts and formulation of rehabilitation plans, we have been able to develop analyses in which lenders and investors have confidence and on which they are able to rely.

The second critical element is the development of a proposed organizational structure that will yield the greatest possible efficiencies in the management of the new railroad. A significant element of the costs incurred by the major railroads relates to overhead for a headquarters corporate staff and the manpower and facilities to coordinate the operation of a large, complex rail system. A regional railroad can—and must—reduce these overheads significantly. By having a small management staff operating from offices on the line itself, the new railroad can eliminate substantial costs that reduced the profitability of the line for the seller. This, of course, sounds far easier than it actually is, for the new, lean management must have, or be able to draw upon, the same broad range of skills that a major railroad supplies through its headquarters staff.

The third critical element in putting together a profitable regional railroad is to refocus marketing activities so that the maximum possible traffic can be generated from current and potential shippers on the line. Given their size and geograhpic scope, major railroads often cannot devote enough individualized attention to shippers—particularly smaller shippers on what are considered secondary or marginal lines. A regional railroad can—and, again, must—provide that attention for all of its potential shippers. In seeking to maintain and increase traffic, a new railroad has to be flexible in developing rate proposals, and must use the pricing freedoms provided by the Staggers Act—and in particular the contract rate mechanism—in creative and aggressive ways. In this connection, a regional railroad can often be more flexible than a large Class I railroad in its pricing, since it need not be concerned about the impact of one rate reduction on other movements on other parts of its system.

The fourth element that Foster believes is critical to the successful establishment of a new regional railroad is the ability to employ its workforce more effectively. This major railroads are subject to national labor agreements that significantly limit flexibility in the workplace and quick, efficient responses to changing economic conditions. I would emphasize that this does not mean that the creation of a new regional railroad is a "union-busting" device. On the contrary, Foster is entirely neutral as to whether the employees of a regional railroad choose to be represented by a union. The G&M employees, for example, are unionized, as are those of several of the other major regional railroads. In our view, what is important is not the question of unionization, but the ability to be free of the more burdensome provisions of the national labor contracts. If suitable work rules can be established, we believe that either a unionized or nonunionized regional railroad can achieve all of the necessary efficiencies to be an attractive investment. By establishing more flexible work rules—which our experience with the G&M shows can be done through negotiation with the employees' unions—a new railroad can significantly reduce its overall labor costs and, at the same time, make broader use of its employees' skills. Even more important, the establishment of a new railroad also affords an opportunity to give employees a real stake in the success and growth of the operation, by means such as a profit sharing or an employee stock ownership plan.

The final element that we believe is necessary to the success of a new regional railroad is a firm financial foundation which will permit both ongoing operations and future growth. If the project is sound in concept and properly planned, a combination of equity holders, institutional investors and lenders can be brought in to provide that foundation.

WHAT CONGRESS CAN DO TO ASSIST IN THE DEVELOPMENT OF REGIONAL RAILROADS

I hope that the preceding comments have given you a sense of the opportunities that exist with respect to the development of new regional railroads, and what Foster has done to participate in that development not merely as a one-shot deal but on an ongoing basis. I would like to conclude by offering some suggestions as to what the federal government can do to facilitate the continued growth of the regional railroad industry.

First, and most important, it is essential to preserve the actions Congress and the Interstate Commerce Commission have taken through the Staggers Act to let market forces rather than regulation govern the formation and operation of new carriers. Flexibility in adjusting rates is critical to the success of a new carrier, and any effort to roll back deregulation in this area would make investment in regional railroads far less attractive. Similarly, the steps the ICC has taken to eliminate traditional layers of regulation in the start-up process should not be undercut. In creating the G&M, more than a year was required to obtain ICC clearance for the new railroad, with extensive evidentiary filings and resulting costs and delays. Now, under the "class exemption" recently adopted by the Commission, new carriers can be put into operation with a straightforward seven-day notice. Clearly, the current approach makes the entire transaction more efficient and reduces the likelihood that potential investors will be deterred by the prospect of unending regulatory delays.

Second, I would urge Congress to focus on the need to find some means to help new regional railroads cope with the current liability insurance crisis. As you are aware, the cost of liability insurance has reached astronomical levels, and coverage in the amounts needed to protect a company in the face of ever-increasing jury verdicts is often unavailable at any price. At the present time, Foster has found that the maximum coverage we can obtain for a regional railroad is insurance of $25 million, subject to a $1 million per incident retention—and the cost of this coverage is approximately $1 million per year. This has two impacts on a new railroad: first, the insurance premium itself is a major item of expense; and second, the provision of a substantial self-insurance retention requires the creation and maintenance of a large reserve. Establishing such a reserve is a real problem for a new regional railroad, because it not only increases the initial investment required but in addition it adds to the on-going cost of doing business. Moreover, this cost is magnified by the fact that, under the current tax laws (and both the House and Senate bills now being considered by the Conference Committee), such reserves are non-deductible. Where the economics of a potential project are on the borderline, as is often the case with a proposed regional railroad, these added costs can make the difference between a project that is economically attractive to investors and one that is not.

The liability insurance crisis has a further impact on the caliber of management expertise that a regional railroad is able to obtain. As I previously explained, one of the critical elements for a regional railroad is the development of a highly efficient management structure with a broad range of skills concentrated in a small number of individuals. In today's litigious environment, an absolute prerequisite to attracting qualified persons to serve as officers or directors of a new company is the provision of adequate officers and directors' insurance. The difficulty faced by a new regional railroad in obtaining such insurance thus has a direct impact on its ability to obtain the management skills necessary to make the new railroad a success. Any action that Congress could take to alleviate the current liability insurance crisis could thus have a very positive impact on the development of regional railroads.

A third area I would like to mention concerns outmoded railroad laws which, while affecting all railroads, have a particular impact on a new regional railroad. For example, job-related injuries to employees in virtually all other industries are subject to worker's compensation statutes, under which compensation is fixed by defined criteria without regard to fault. The railroad industry, however, is still subject to the Federal Employers' Liability Act, 49 U.S.C. §§ 51-60, enacted in 1908. Under the FELA, job-related injuries of railroad workers are the subject of personal injury suits which are tried to a jury with no limit on potential damages, under legal standards in which the worker must prevail if even a scintilla of negligence by the railroad is shown. Given the minimal showing of negligence which is required to establish liability and the continuing increases in the size of jury verdicts, this exposes a new regional railroad to potential liabilities not faced by new companies in other industries and constitutes a disincentive to potential investors.

Finally, I am often asked whether the development of regional railroads might be encouraged by additional federal funding. While additional funds are always helpful, we do not think it can ever be a make-or-break proposition for a proposed new carrier. Foster's practice is to evaluate a project on the assumption that no federal financial assistance will be available. We think this is the only prudent course, and that it will lead to a more conservative, businesslike assessment of the new railroad's capabilities and prospects. If, in fact, additional funding can be made available, it should be provided in a form—such as fixed grants—that potential investors can be certain will be available and can therefore reliably take into account without overestimating the financial prospects of the proposed new railroad.

Thank you for the opportunity to appear here today. I would be happy to answer any questions you might have.

Questions of Senator Pressler and the Answers

Question 1. The secondary boycott issue is a big issue today. What effect, if any, might this have on regional and short line railroad development?

Answer. It is my understanding that there is a serious issue as to whether secondary boycotts are lawful under the Railway Labor Act. If it should ultimately be held that secondary boycotts are lawful, their impact on short line or regional railroads could be especially severe. Because of its limited resources, a short line or regional railroad is less able to withstand a period of lost revenue resulting from a secondary boycott than a typical Class I carrier.

I also believe that any sanctioning of secondary boycotts in the railroad industry would constitute a disincentive to potential investment in short line or regional railroads because the potential impact on revenue would create an additional uncertainty. Investors would also take into consideration the fact that, in those industries subject to the National Labor Relations Act, secondary boycotts are not lawful, thus making investment in a short line or regional railroad relatively less attractive than an investment in other industries.

Question 2. How do we avoid allowing track to deteriorate to a point of no return, making abandonment the only option? How do we get to these lines before they are run down so far that a short line or regional railroad cannot make a go of them? Is that an objectively identifiable point in the life of a line?

Answer. In my opinion, Congress has already provided the key vehicle for early identification of lines which may become candidates for abandonment—the system diagram maps filed with the Interstate Commerce Commission.

As I understand it, Congress has directed the Commission to require all carriers to maintain on file with it a diagram of the carrier's transportation system identifying lines potentially subject to abandonment (49 U.S.C. § 10904). Under the Commission's regulations (49 C.F.R. § 1152.10-1152.15), every railroad must file a color-coded map which places every line in its system into one of five categories. Category 1 consists of lines the railroad anticipates will be the subject of an abandonment application within the next three years; and Category 2 consists of lines potentially subject to abandonment because of either anticipated operating losses or excessive rehabilitation costs, as compared to potential revenues. The railroad is required to publish a notice, including the appropriate portion of its system diagram map, in a newspaper in every county containing Category 1 or Category 2 lines and to furnish a copy of the system diagram map to any person upon request. An updated map must be filed each year. In addition, all lines in Category 2 must be reviewed annually.

In my opinion, the system, diagram map requirement is an excellent tool for identifying lines suitable for short line railroad development before abandonment becomes inevitable. Perhaps some means of publicizing its existence would help to insure more effective use by potentially interested persons.

Question 3. I expressed concern over the need for a kind of benevolent relationship between the large and small railroads to make these divestitures work in the long run. The small railroads, particularly the smallest short lines, seem to be at the mercy of the big lines. In many cases, they exist at the pleasure of the Class I. Is there anything we can or should do to protect the small operators, or to ensure the long term viability and independence of the short line?

Answer. In my opinion, the long-term viability of short line railroads can best be assured through long-term contractual relationships with their connecting Class I railroads. It is often desirable to define these relationships at the beginning of a short line railroad's existence, and it is essential to minimize regulatory and other constraints at this stage. Since the sale of a line to create a new Class II or III carrier results in the existence of two railroads where there previously was only one, certain restrictions normally applicable to dealings between two connecting railroads—including those imposed by the antitrust laws—are inappropriate. I believe that Congress should consider a limited exemption from the antitrust laws for these transactions in order to encourage the creation of new regional and short line railroads with the attendant benefits that they offer to the shipping public.

Senator **Pressler**. Thank you very much.

I would like to call on John Haley, president, Chicago, Central and Pacific Railroad Company, Waterloo, IA.

Mr. **Haley**. Good morning, Senators. I have submitted written testimony.

I am honored to be here. I feel like the last link in the chain of events. I thank you for supporting the Staggers Act, the ICC and the FRA for the roles they have played in helping me obtain ownership of short line and regional railroads. We all talk about them, and I am here to tell you that it is working, and I want to see more of it.

I want to reassure you that it is working. I think I am fairly qualified to say that. I am personally liable for $78.5 million of acquisitions in the regional railroad business. I do not think anybody else in the United States can say that.

I have purchased two small short line railroads and, of course, the Chicago, Central and Pacific over 700 miles, and it is working. We have implemented productivity in our labor contract with the same national unions that were with the ICG before I purchased the Iowa line between Chicago and Omaha. With the exception of one of the national unions, which only represents about 3 or 4 percent of my labor force, we have successfully negotiated very productive labor contracts allowing us to put rates into our operation which are stimulating the economy of Illinois and Iowa.

Senator Rockfeller's West Virginia has coal. My coal is grain. My coal in Iowa and Illinois is grain. It is safe to say that through the productivity we have in the ranks in the Chicago Central that we are able to transport 40,000 cars of grain a year for 3 to 5 cents less a bushel. You multiply that times 3,500 bushels to a carload and you can see the dollars that are flowing into the economy, particularly the economy of Iowa, which is so desperately in need of improved agricultural business at this time.

Senator, as far as labor protection, I think the word is misleading. Labor protection does not protect labor. Labor protection ensures that labor will not be protected. In my case, if labor protection had been invoked the price of the railroad would have been considerably more. The business plan that I put together with the cashflows available would not have been able to service the debt.

I would not have been able to buy the railroad. Instead of increasing the labor force by 100 people, which is what we have done since 7 months and 1 day ago. On Christmas eve of 1985, we had 450 people, and today we employ 560 people, all under national labor contracts at basically the same wages or, in some cases, more than they were being paid. Labor protection being applied would have caused that not to happen and just the opposite result of protection would have resulted.

I think it is important that in some of the short lines the assistance from the various programs is necessary. But the point I would like to make about the Chicago Central and the regional railroad business is that we are finding our niche through productivity and marketing. As Mr. Riley so well put it, our transaction has put the railroad in the hands of a person that wants to run the railroad. That is important because that introduces marketing, and when you are $78 million liable you have a real incentive to market your railroad.

And putting the railroad in the hands of a person that wants to run the railroad, we are profitable. We are operating in the free enterprise system, with private financing at prime-plus, and real equity involved, with no significant assistance of any type from State or Federal Government, and we are showing a profit. We are not only showing a profit; I am forecasting by the end of the year that we will be substantially profitable. Meanwhile, we will perform about $9.2 million in privately financed rehabilitation to the railroad across the States of Iowa and Illinois.

The Staggers Act and the assistance of the ICC and the FRA, the very things that you wanted to happen, are happening, and I want you to know that, and that is why I am here. The rehabilitation of the railroad, the increased economic impact on the States of Illinois and Iowa are real. The 100 people that we have hired with negotiated national labor contracts are real. And that is the effect I trust you wanted from your support of the Staggers Act and I want you to know that it is in fact happening.

[The statement and questions and answers follow:]

Statement of John E. Haley, President, Chicago, Central & Pacific Railroad Co.

Good Morning. My name is John E. Haley. I am President and founder of the Chicago, Central & Pacific Railroad Company (Chicage Central or CC). I am accompanied by Peter A. Gilbertson, Vice President-Corporate Planning of Chicago Central. We appreciate very much the opportunity to appear at this very significant hearing on regional and short line railroads.

Chicago Central is a new company that I created to purchase approximately seven hundred miles of rail line between Chicago, Illinois, on the east and Omaha, Nebraska/Council Bluffs, Iowa, and Sioux City, Iowa, on the west. CC purchased this property from the Illinois Central Gulf Railroad Company (ICG), which directly or through its predecessors had owned the lines (called the Iowa Division) for over eighty years.

The creation of the Chicago Central and the transfer of ownership of the Iowa Division by ICG to CC is an overwhelmingly positive development in the railroad industry, with direct and tangible benefits for shippers, employees, and other Class I railroads. In the balance of my testimony, I will describe the Chicago Central and the conditions that permitted it to come into being. This transaction can provide some lessons for transportation policy in the 1980's and beyond.

THE CHICAGO CENTRAL PURCHASE TRANSACTION

Chicago Central closed its purchase of the Iowa Division on December 24, 1985, after a unanimous decision of the Interstate Commerce Commission exempting CC from the entry provisions of the Interstate Commerce Act. The purchase included over 700 route miles of track in three states, 80 locomotives and over 800 units of rolling stock (a map of CC lines is attached). CC also agreed to offer employment to 450 existing ICG employees. The purchase price was $75 million, which CC financed solely from private sources, primarily General Electric Credit Corporation and Midwest Energy Company.

Illinois Central Gulf decided to sell these properties to CC for a variety of reasons. First, it concluded that this east-west property did not fit within ICG's strategy as a north-south railroad. Second, ICG was unable to reduce its costs and market its services to the extent necessary to earn sufficient returns on its investment. The options available to ICG included partial or total abandonment of the lines, downgrading of the lines, sale to an existing carrier or sale to a new, non-carrier entity such as Chicago Central. For reasons I will describe, the last option maximized benefits for ICG as well as shippers, on-line communities, and employees.

In its six short months of operations, Chicago Central has been able to implement a variety of positive actions:

Labor and employment.—As a new, non-carrier entity purchasing a portion of the assets of another company, CC had no obligation to assume existing labor agreements. Nevertheless, prior to commencement of operations, CC conducted extensive and time-consuming negotiations with each of the nine railroad labor organizations representing positions that would exist on the new carrier after start-up.

The results of these painstaking negotiations have been extremely significant. Chicago Central agreed to offer preference in employment to prior ICG employees at competitive basic rates and in order of seniority and to honor vacations accrued at ICG. More significantly, CC agreed to a contractual bonus system that permits employees to share in the growth and productivity of the company. In return, the employees and CC agreed to significant modifications in outdated work rules. These rule modifications permit CC to be a much more effective competitor than its predecessor.

The positive results of the foregoing have been tangible even in CC's short existence. Since commencement of operations six months ago, CC has hired over sixty additional employees, most in permanent, non-management positions. This employment increase is in stark contrast to the decades of job losses both on the property CC acquired and on railroads nationally.

Service.—In part because of its dedicated and efficient work force, CC has taken steps that substantially improve service to shippers. Highlights of these improvements include:

Additional train frequency.—CC has at least doubled train frequencies on key routes, with the result that every CC shipper has the opportunity for service at least twice each business day.

Intermodal.—CC has established dedicated intermodal trains, established five new intermodal facilities, and has, through its intermodal contractor, placed new equipment into service.

Track rehabilitation.—CC is in the process of a 1986 program of investing over $4 million of private funds in track and facility rehabilitation, over and above normal maintenance. The result of this annual program is better and safer service.

Marketing.—CC has developed an aggressive and innovative marketing department that has taken full advantage of Staggers Act pricing freedoms, including executing over 170 contract rates and over 80 exempt quotations for boxcar traffic. CC has also implemented a gathering train concept which has been well accepted by grain shippers. This program provides large and small shippers alike with the economics of unit-train movements. Each of these efforts is beginning to bear fruit, with the continuing return of customers who had not used rail in years.

Community relations.—The creation of Chicago Central has had a significant positive impact upon the communities it serves. Beyond the fundamental benefit associated with improved transportation service, CC has made investments of time and money in the local communities in its service area. Projects include involvement in local development projects, supporting community projects, localized purchasing, refurbishment of railroad buildings, and a host of other projects, including CC's participation in a joint venture that will bring fiber optics communications to a number of cities along its route.

Interline arrangements with other carriers.—Chicago Central has enjoyed cooperative relations with virtually all of the twenty rail carriers with which it connects. CC participates in hundreds of joint-line movements under contract or joint rates. As such, CC strengthens the national rail network and adds to options available to shippers.

FACTORS CONTRIBUTING TO THE SUCCESSFUL FORMATION AND OPERATION OF REGIONAL RAILROADS

The recent development of major regional railroads such as Chicago Central is in part a function of the development of structural conditions that nurture and facilitate growth. Shippers, communities, class I carriers, employees, labor organizations, and the U.S. Congress have a stake in ensuring that these conditions are maintained and expanded.

Let me describe some of the most important factors that I believe affect, both in a positive and negative sense, the development and growth of regional railroads.

Labor/management relations.—A cooperative and realistic approach to labor management relations is an absolutely imperative prerequisite to the creation and growth of regional railroads. Labor organizations must recognize that fundamental changes in work rules are in the interest of railroad employees as well as management. At least as important, railroad managements must realize that work rule changes per se are not a panacea nor merely a way to provide reduced service more inexpensively. Work rule changes are in fact worthless without a management commitment to marketing and service. Moreover, we believe that sharing the growth of the company with labor and management employees alike is an absolutely critical element in developing railroad companies that are able to compete in today's transportation environment.

Unfortunately, a few railway labor organizations appear to be more concerned with imposing artificial limitations on productivity than in confronting the basic issues of growth. However, Chicago Central and the unions it has contracted with provide evidence that many of the nation's railway labor organizations are committed to the changes that are necessary in order for the industry to grow.

Law and Regulation.—Congress and the Interstate Commerce Commission are to be commended for implementing regulatory freedoms that have helped facilitate the creation and growth of regional railroads. These freedoms, which have been absolutely critical to growth, have occurred primarily in the areas of entry and exit, and in pricing. In certain other areas, additional reforms are necessary:

Entry and exit.—As was envisioned by the Staggers Rail Act of 1980, the Interstate Commerce Commission has acted to implement national transportation policy by easing burdens on entry to, and exit from, the industry (See 49 U.S.C. § 10101a(7)), and by exempting transactions from the provisions of the Interstate Commerce Act when continued regulation is unnecessary. See 49 U.S.C. § 10505. For example, the Commission has consistently exempted new carriers seeking to purchase rail property from existing carriers from the otherwise applicable entry provisions of 49 U.S.C. § 10901. *See, e.g., Gulf & Mississippi Railroad etc.*, Finance Docket No. 30439, (Served January 2, 1985). Exemption of these transactions, which has reduced transaction costs and delay, has been extremely important to the implementation of these transactions.

The recent decision of the Interstate Commerce Commission granting the petition of Anacostia & Pacific Corporation for a class exemption for the purchase of rail lines by a new carrier will further improve this process. *See Ex Parte* 392 (Sub. No.-1) (Served January 17, 1986). This new procedure, for which the Commission is to be commended, enables a new carrier to commence operations quickly on a date it selects while preserving the rights of interested parties.

CC was unable to take advantage of this procedure because the procedure had not been established at the time of sale. However, this procedure, which became available two months later, would have permitted CC to avoid months of uncertainty and delay, hundreds of pages of testimony and thousands of dollars of legal expense. Most importantly, we could have commenced operation in the late summer prior to the end of the construction season and the grain harvest. The regulatory result would have been identical since CC's petition ultimately was approved unanimously by the Commission.

Labor protection.—The Commission has adopted the general policy of declining to impose labor protection obligations in transactions involving the transfer of railroad property pursuant to 49 U.S.C. § U.S.C. § 10901. This policy has been sustained by the courts and is wholly consistent with national transportation policy.

The Commission has recognized correctly that imposition of labor protection will often make the sale of lines to new operators hopelessly uneconomic. The perverse result in such case would be the loss of railroad employment. The Chicago Central transaction, for example, would not have occurred if labor protection were imposed. Such a result is emphatically not in the interest of labor organizations or their members.

Pricing.—The increased pricing freedoms offered railroads by the Staggers Act have done a great deal to return profitability to rail operations, and thereby attract private capital to new regional railroads. At the same time service has been improved. Or specific importance has been the contract rate and exemption provisions of the Staggers Act. Any new restrictions on the ability of railroads to price their services would have the opposite effect.

Compensation of injured employees.—Instead of the workers' compensation systems that are applicable to virtually all other transportation and industrial corporations in the United States, railroads are subject to the Federal Employer's Liability Act (FELA), 45 U.S.C. § 351 et seq. FELA provides a "system" for compensation of railroad employees injured as a result of carrier negligence. This antiquated system leads to grossly inconsistent results and imposes burdens on railroads that are substantially greater than those imposed on other industrial corporations. Elimination of this system in lieu of a uniform workers' compensation system similar to existing ones used by other industrial corporations is long overdue. Such reform would have a significant positive impact on new and existing carriers.

Financing.—With the revolutionary changes described above, the capital markets have begun to show significant interest in investing in regional railroads. For example, in the last year, over $220 million in private capital has been raised to facilitate the formation of three regional railroad systems.

Private capital will continue to be attracted to railroad investments if artificial regulatory restraints are minimized.

Despite the increasing availability of private financing, we do believe that there is a role for some level of public participation in railroad capital programs. Some states, such as Illinois and Iowa, have substantial programs providing funds for projects having important public benefits. Theere is also a role for federal financing, although not necessarily on the scale previously available. One attractive concept for a federal financing program that would provide substantial public benefits without a large funding commitment would be an interest rate "buydown" program for privately originated loans for railroad rehabilitation or facility construction having public and safety benefits. Such a program would combine the presence of a private sector lender receiving market rates for use of its funds with a small federal interest reduction payment where warranted by the public benefits of the project. Such a federal role need not be large but could have significant benefits where exclusive private sector funding is not available for the project.

Insurance.—Obtaining affordable property and liability insurance may become the single largest impediment to the formation and growth of regional railroads. For new carriers, the issue is often whether insurance is available at any price. Existing carriers must cope with unilateral premium increases of 50 to 100 percent and substantial increases in deductibles or self-insured retentions (SIRs). Chicago Central supports efforts to reform the nation's tort laws and other steps to ensure the continued availability of affordable insurance to the nation's business.

CONCLUSION

The emergence of new regional railroads is an extremely beneficial development for the railroad industry and the shippers, employees and companies interested in its future. I believe that it is crucial that Congress support and nurture this development. I commend you for your interest in this development and your willingness to consider the steps necessary to support continued growth.

I will be glad to answer whatever questions you may have.

QUESTIONS OF SENATOR PRESSLER AND THE ANSWERS

Question 1. What effect does FELA have on small and regional operators?

Answer. The Federal Employee's Liability Act (FELA) rather than so-called Workman's Compensation governs the handling of on-the-job injuries to railroad workers. Railroad workers are the last major employee group covered by this archaic system. FELA was doubtlessly introduced with good intentions but the effective result of FELA is to create an adversarial relationship between the employer and the employee; and to needlessly drive up the liability costs of the railroads.

The liability insurance crisis for railroads is particularly difficult because of the added burden of FELA with its attendant unknown of final liability.

All railroads, but most particularly small and regional operators, are handicapped by their continued participation in FELA. The potential exposure of the railroad under FELA is a major source of concern on the part of investors analyzing small and regional railroad opportunities—a salutary effect on the formation of small and regional railroads will flow from the termination of the FELA and the conversion of railroad employees under a Workman's Compensation system.

It is time for this remaining vestige of a vanished era of adversarial industrial relations to be retired.

Question 2. How do we avoid allowing track to deteriorate to a point of no return, making abandonments the only option? How do we get to these lines before they are run down so far that a short line or regional railroad cannot make a go of them? Is that an objectively identifiable point in the life of a line?

Answer. This question confronts the challenge of our capitalistic system—how do we motivate committed profit and service oriented management? The sad experience of regulation in the U.S. and government ownership elsewhere proves that government cannot and should not manage the railroads. The challenge to government, I believe, is to focus on those points which will further the development of the American railroad network. Several steps are required:

(a) *Create a level playing field.*—The American transportation scene pits privately owned and operated railroads against air, highway, and water modes enjoying the benefit of massive government capital investment and operating subsidy. Repeated studies by impartial observers indicate that commercial air, highway, and water modes do not pay their "fair share" of the further public facilities and services they use. The continued direct and indirect subsidies to rail competitors skew the nations productivity curve the wrong way as true low-cost transportation, railroads, are unable to match their artificially low-cost competitors.

(b) *Orient the abandonment process towards continued service.*—Current regulatory practices have created the opportunity for abandoning railroads to control the abandonment process to effectively foreclose viable successor operators by targeted abandonment of selected line segments and by the lack of regulatory incentives to seek successor operators rather than abandonment.

Regulation of railroad abandonments should continue but in a framework whose goal is the preservation and revitalization of rail service.

(c) *Encourage early, comprehensive and decisive railroad restructuring.*—There is no objectively identifiable point of no return in the life of a railroad. I am familiar with abandoned lines where the last train traveled at over 80 mph and others where the last trains were loaded with freight. Under deregulation the ability of willing and able managements to reverse the decline of the railroad is now possible. Railroads, of whatever size, not committed to profit, service, and market penetration, should be encouraged to dispose of their lines as soon as possible in bold and complete restructuring. The creation of railroads "big enough to serve you and small enough to care" is a welcome result of the restructuring of some large railroads into multiple regionals.

I favor legislation which encourages through tax policy or other appropriate means, the quick, divestiture of regional-sized units of railroad at the earliest possible occasion. This will permit the introduction of aggressive new management prior to the onset of the dismal spiral of physical deterioration and traffic loss that is so difficult to reverse.

Senator **Pressler**. That certainly is good news from one area, and we thank you very much.

I shall next call on Larry McCaffrey, Weiner, McCaffrey, Brodsky, and Kaplan, Washington, DC.

Mr. **McCaffrey**. Thank you, Senator.

Senator, I am here appearing on behalf of Pete Claussen. Pete Claussen is the president of the Mississippi Delta Railroad and the Alabama and Florida Railroad. The reason he is not able to be here today is that he is closing on the startup of yet a new railroad, the Alabama and Florida Railroad.

The extraordinary growth in short line railroads occurring today is the result of several factors: first, the recognition by large railroads of the value of feeder lines to their system; second, the availability of private capital to acquire such properties; and, third, the growth of professional short-line operators.

Mr. Claussen owns and operates two railroads. The first, the Mississippi Delta Railroad, located in northwestern Mississippi, was acquired from ICG in 1985. It has 60 miles of track, employs seven persons, and handles approximately 6,000 carloads annually. Five of MDR's employees came from the ICG.

The second railroad is the Alabama and Florida Railroad, which is being acquired from CSX today. It consists of 107 miles of track. It, too, will have seven employees and it will handle approximately 8,000 carloads annually. Each of these railroads was entirely privately financed.

You asked Mr. Claussen to comment on areas where action could be taken to encourage the formation and operation of such railroads. Let me provide his comments. First, it is essential that the ICC's policies in transactions involving new carriers, such as these two, of not imposing labor protection on either the buyer or the seller, be maintained. The cost of such protection simply cannot be absorbed directly or indirectly by new carriers.

Further, the expedited procedure of ICC approval under ex parte 392 is a major benefit to controlling costs at startup and assuring a smooth transition. In fact, these two railroads demonstrate that difference. In the Mississippi Delta case, Mr. Claussen waited months for ICC approval; in the Alabama and Florida case, he could close in 7 days after filing the notice. That is a major benefit to controlling startup costs.

Second, the ICC's cost recovery system is the only means of recovering cost increases where traffic growth is flat. In fact, it may be that short lines are only able to maintain, or offset lost traffic and never really get a lot of growth. Yet this cost recovery system does not reflect short line costs. Thus, short lines, particularly the marginal ones, may face a long-term cost squeeze if the system is not modified as applied to small railroads.

Third, the costs of the railroad retirement system and Federal Employers' Liability Act are extraordinary and inequitable for short lines. Mr. Claussen's full testimony testifies in some length on that point. Let me state that these laws are out of date and greatly hamper a short line's ability to compete with other modes who do not carry these types of costs.

Fourth, there remains a role for public assistance. Many new short lines face substantial rehabilitation burdens if service is to be preserved over the long term, notwithstanding the fact that capital is available for acquisition and startup. Mr. Claussen suggests that an interest buy-down program directed at such costs would be a major benefit without substantial impact on the Federal budget.

In sum, short lines have much to offer—improvements of railroad service, greatly enhanced local marketing, improvement of the economic efficiency of railroads, and the preservation of railroad employment. I appreciate the fact that you have recognized these benefits and have conducted this hearing to discuss opportunities for expanding the benefits.

Thank you.

[The statement and questions and answers follow:]

STATEMENT OF PETE CLAUSSEN, PRESIDENT, MISSISSIPPI DELTA RAILROAD AND ALABAMA & FLORIDA RAILROAD

It is timely and appropriate for this Subcommittee to examine the condition of the local and regional railroad industry. I am pleased to be able to participate in your hearing even though a conflict prevents me from appearing personally. That conflict is that today I am acquiring another railroad property to be known as the Alabama & Florida Railroad. I have asked Larry McCaffrey, counsel for my railroads, to present my views.

The railroad industry is now entering a new post-Staggers Act phase. The first phase was characterized by the disposal of most marginal properties owned by the Class I carriers. Many were dismantled. The rest became shortlines, often with considerable shipper and/or public sector financial assistance. These lines have had many predictable financial failures and many successes, some surprising. As a result, many people like me have come to understand what it takes to have a successful small railroad.

The second phase evolved from the first: the properties becoming available started to get better; the operators became more experienced; and the Class I carriers realized that effective feeder line operations could be established on many of their branches. Accordingly, many of the new lines being formed today are privately financed, unsubsidized for the most party by shippers or the public sector, and operated with a profit motive much like any other business. The Mississippi Delta Railroad, which I own and operate, is typical.

Mississippi Delta was acquired in late 1985 from the Illinois Central Gulf Railroad. It is located in northwestern Mississippi and is sixty miles long. It consists of twenty miles of ICG's former Memphis-Vicksburg-New Orleans mainline. Most other segments of the mainline were abandoned by ICG. The railroad also includes thirty miles leased from ICG and ten miles leased from a third party. The purchase was achieved entirely through private funding. The railroad handles from 80 to 140 carloads per week and is meeting traffic and revenue projections. About 80 percent of the traffic, which is principally cottonseed meal and oil and soybean meal and oil, is handled on a switching basis for ICG at a uniform fixed rate per car.

Locally-based railroads have the motivation and ability to identify pockets of traffic that a Class I owner might overlook. Mississippi Dalta is no exception. We work diligently with both existing and potential customers on rates and elements of services. A new siding to one customer has just been completed and negotiations with another customer for a new siding are nearly complete. Active negotiations are under way with a grain shipper to return his business to the railroad and new unit train and multiple car rates are being developed by the ICG at our request for a national customer who is our largest shipper. Therefore, I believe there is a high likelihood traffic will increase on the line significantly.

Our role in the community becomes larger than that of ICG when it provided the service because we become customer advocates as well. Being a carrier, we can deal on a railroad-to-railroad basis. This often gives us direct contacts with decision makers on other railroads, frequently with people we know personally. Several

Class I carriers even have positions like "Manager of Short Line Sales" for the purpose of providing a direct way to address the needs of short lines and their customers. Either way, the result is that we often can get things done quickly that are slow or even impossible for a customer to do.

Our ability to serve the community is directly attributable to our excellent employees: six full-time and one part-time. It is interesting to note that under ICG ownership there also were six full-time and one part-time employees on the property, but only four of the seven jobs are the same. Five of our employees came from the ICG, one from another Class III railroad and the other from a non-railroad job held by the employee after his job with the Rock Island ended with its bankruptcy. All but one of our employes will have the same or greater income with our railroad than they had in the preceding year.

Mississippi Delta Railroad's selection of former ICG employees was voluntary. No labor protection was imposed and, if it had been, there would have been no transaction. It is very important to recognize that even though we have the same size workforce as ICG had, many of our people are in different jobs and at wage levels prevailing in the area. Labor protection would have deprived us of the ability to match our personnel with our jobs and would consequently have driven costs up to such an extent that neither we nor our lender would have been interested in the transaction. Continuation of open labor market concepts for new short lines is absolutely essential and can, as it did on the Mississippi Delta, be a good thing for labor as well.

As I mentioned, today I am starting the Alabama & Florida Railroad, which consists of two segments of Seaboard System track totalling 107 miles in southern Alabama and the Florida panhandle. The railroad is located over 500 miles from the Mississippi Delta Railroad and the two railroads will be operated independently under my oversight. I expect the Alabama & Florida to generate approximately 8,000 carloads of traffic annually, principally forest products. The railroad will have seven employees, virtually all of whom are expected to come from Class I railroads, thus preserving jobs for existing railroad employees. Like Mississippi Delta, the railroad will also be entirely privately financed.

The Alabama & Florida Railroad received an exemption from Commission approval in order to begin business through the Ex Parte 392 procedure adopted in January by the Commission. This procedure enables me to begin business seven days after filing a notice at the Commission. This contrasts with the months it took the Mississippi Delta railroad to receive an exemption under the old procedure. The Commission's adoption of the Ex Parte 392 procedure has been a great benefit in controlling start-up costs and assuring an orderly transition between buyer and seller.

You have asked me to comment on areas where action could be taken to encourage the formation and operation of railroads such as the two I have described. I have already commented on the fact that these transactions were not subject to labor protection requirements. If they had been, the transactions would not have occurred and the lines would soon have come up for abandonment. Continuation of the Commission's policy of not imposing labor protection in such cases is crucial to preserving the benefits of these transactions.

Another important problem relates to RCCR, the railroad cost recovery index administered by the Commission. Once short lines strike a deal on switching charges or divisions of revenue, it almost never changes. Those agreements are nearly always tied to RCCR. Today, per car revenue for short lines often declines because of the need to join in contract rates or because of rate reductions. Traffic growth is the only effective way to increase revenue, and may be necessary just to stay even. The RCCR formula is supposed to increase rates automatically as railroad costs increase. But the costs are determined by Class I railroad experience, which is often widely different from the short line experience. For example, within the last year insurance costs, which short lines pay but Class I railroads do not because they are self-insured, have jumped dramatically. For many lines, the increases involve three or four percent of gross revenue. Yet the RCCR index is two percentage points below its level of a year ago. This index is simply not reflective of the cost experience of short lines and, if left unchanged, could have a serious long-term impact on short lines being formed.

Another critical problem involves the Railroad Retirement System and the Federal Employers Liability Act. The direct labor burden for short lines under the Railroad Retirement Act is now about 30% and will increase sharply because of surcharges and probable general increases. There have been major declines in employment throughout the railroad industry. For example, Conrail has 60,000 fewer employees than it did a few years ago. Thus, there are more and more people in retired status and fewer and fewer making contributions. So the employer's share is going up and up for all railroads, large and small. But the small ones are not the ones that are creating the problem. Short lines are employing more and more people each year, and within individual lines employment tends to be stable. In short, we are paying for the impact on the Railroad Retirement System that results from the Class I railroad efforts to become more efficient. That is inequitable and terribly burdensome, making competition with other modes extremely difficult. Short lines ought not be under the System at all, but if they must be, their taxes should be reduced appropriately.

Likewise, the Federal Employers Liability Act offering railroad employees a special avenue for compensation for workplace injuries is having a major negative impact on small railroads. Short lines enjoy very good relations with their employees and thus have low FELA claims experience. Class I railroads, on the other hand, have in many cases not had such good relations and, where that occurs, tend to show high FELA claims. As I mentioned previously, short lines pay outrageously high insurance premiums, which includes FELA coverage, despite very favorable claims experience. Again, short lines are paying for costs driven by the experience of Class I railroads. The FELA system is out of date and should, for short lines at least, be replaced by the workers compensation system used by the rest of the American workforce.

My final major concern is in the area of Federal financial assistance. Mississippi Delta Railroad has received no state or federal money and the Alabama & Florida has no plans to apply for public sector assistance. The main reason is that very little such money is available: none for purchase and hardly any for track work. We believe that nevertheless we can maintain the properties as required and service our debt at the same time. If we can't, the maintenance is what will suffer.

For others, maintenance may already be suffering in part because insurance and Retirement System tax increases cannot be deferred. There should be a program to help keep local and regional lines in shape, particularly where they may be taking on properties with serious levels of deferred maintenance. One suggestion would be an interest buy-down program, with the recipient obligated to spend the savings on track work. Such a program would also help new enterprises obtain financing because of Federal participation. Such a program could be funded, as Tennessee has just done, by allocating a portion of the fuel tax paid by railroads much in the same way the highway fuel tax is allocated. I hope you would carefully consider a program such as this as a surrogate solution to some of the problems I have addressed which may not have easy direct solutions. It also would put the dollars into the track where dollars must be spent if rail service is to continue.

When short lines begin operating, rail traffic soon increases, service becomes more frequent, shippers find that the new railroad is their ally, and railroad employment is sustained rather than lost due to abandonment. I have mentioned some of the problems that may cause short lines to fail or be weakened to the extent that they cannot provide the service that they should, and I have suggested a few ways in which they might be strengthened. Nevertheless, the contribution that has been made and will continue to be made by short lines is extremely important to improving transportation efficiency and strengthening local economies. I very much appreciate the opportunity to share these views with you.

QUESTIONS OF SENATOR PRESSLER AND THE ANSWERS

Question. How do we avoid allowing track to deteriorate to a point of no return, making abandonment the only option? How do we get to these lines before they are run down so far that a short line or regional railroad cannot make a go of them? Is that an objectively identifiable point in the life of a line?

Answer. Track deterioration and subsequent abandonment is best avoided by keeping the track in the hands of those who can operate it profitably. Although a simplification, service downgrades, deferred maintenance and eventual abandonment of a rail line occur when the maintenance of the track at a standard suitable to a particular level of service is uneconomic in light of the marginal value of a line to the Class I.

A rail line that is unprofitable or only marginally profitable to a Class I may be highly profitable in the hands of a small or regional railroad. Small railroads typically have extremely flexible labor arrangements that permit use of employees for a variety of tasks. Labor productivity resulting from such flexibility and other factors can mean a significant cost advantage for small carriers. On the revenue side, the small carrier often can enhance traffic by providing a responsive, locally based, retail-oriented marketing effort that would not be cost-effective for a larger carrier.

When a line is slated for abandonment, service is gradually downgraded, maintenance is deferred, traffic on the line erodes and employees are laid off. Less and less money is spent on the line. But the time of the abandonment, although labor protection will be imposed on the Class I, there are few employees left to be protected. On the other hand, if the track is being maintained and service is not downgraded, the number of employees remains constant. Labor protection at this juncture is an expensive proposition.

To get lines slated for abandonment into the hands of a short line who can operate it profitably, there must be an incentive for the Class I to seek sale of the line rather than abandonment. At least with respect to acquisitions by non-carriers, that incentive currently exists. Under § 10901 of the Interstate Commerce Act the imposition of labor protection in acquisitions of rail line by non-carriers is left to the Commission's discretion. The Commission's policy has been not to impose labor protection. The Class I railroad therefore has an incentive to maintain track in condition useful to a potential buyer. The cost of maintenance of the line and payment of salaries for the number of employees associated with that higher level of service is outweighed by the ability to sell the track without liability for labor protection for those employees. However, if the Class I will be subject in any event to labor protection, there is less incentive to continue to incur the cost of maintenance of the track at previous levels with a full contingent of employees.

The point at which deterioration of track makes operation by even a short line unviable, depends on many facts. For example, the amount of traffic anticipated, the level of service necessary for that traffic, the anticipated revenue, and the cost of rehabilitation relative to that revenue are just a few factors to be considered. However, what is most important is that the incentives for sale rather than abandonment of a line be preserved so that track is not left to deteriorate beyond the "point of no return."

Question. I expressed concern over the need for a kind of benevolent relationship between the large and small railroads to make these divestitures work in the long run. The small railroads, particularly the smallest short lines, seem to be at the mercy of the big lines. In many cases, they exist at the pleasure of the Class I. Is there anything we can or should do to protect the small operators, or to ensure the long term viability and independence of the short line?

Answer. The new carrier seeking to purchase rail property from a Class I carrier can protect itself from abuse in several ways. The new railroad should insist that the Class I either sell it enough track such that it connects with more than one major railroad or otherwise provide access through rate or haulage arrangements as will enable it to have access to another major carrier. This competitive protection is usually sufficient to assure that the new carrier is not treated unfairly. If the selling Class I carrier is unwilling to permit such access, then the new carrier must extract a long-term contract from the Class I that preserves fair rate allowances or divisions, interchange arrangements and car hire payments. Without these protections, and I believe structural protections are preferable, a new company should not agree to purchase a rail line. Indeed, in most instances, lenders and investors will not provide funding to purchase the property without such protections. I am dubious that any legislation can be effective in protecting the new carrier's interests. The new carrier must protect its own interest at the negotiating table.

Senator **PRESSLER**. Thank you very much. I understand you have written a book in this area and I very much look forward to reading it, with your vast experience.

Next I call on H. Leroy Weidner, vice president of the Allegheny Railroad.

Mr. **WEIDNER**. Thank you, Senator. My name is Lee Weidner and I am employed as vice president of Allegheny Railroad Co. and as director of corporate transportation for Hammermill Paper Co., the parent company of Allegheny Railroad.

The Allegheny Railroad is a regional railroad 150 miles long which operates in Pennsylvania. It is a wholly-owned subsidiary of Hammermill Paper Co., a forest products company with annual sales of $2 billion. It started operations in 1985 following 3 years of purchase negotiations and the necessary efforts to obtain ICC authorization to purchase the railroad and operate it as a class III common carrier.

The Allegheny Railroad was a Penn Central branch line prior to the formation of ConRail. It was included in the ConRail system but service on the line was abandoned in 1981 and 1985 under the provisions of NERSA. The purchase funding of the railroad in the amount of $5 million was provided by the parent company, Hammermill Paper Co. The railroad is currently being rehabilitated to FRA class III track safety standards at a cost of $11 million. Of this amount, Hammermill is funding $5 million, and the Commonwealth of Pennsylvania and the Federal Railway Administration jointly are funding $6 million.

Hammermill is a capital-intensive company and does not like to make capital investments outside of its primary business lines. The total cost of the railroad was about $20 million. Without the $6 million of State and Federal funding of the rail rehabilitation program, Hammermill would not have entered the railroad business.

The railroad has a freight base of 15,000 carloads per year. Of this amount, 11,000 carloads represent the parent company's freight, and the remaining 4,000 carloads represent other commercial traffic. The railroad could not sustain itself and be profitable without the parent company's freight. With Hammermill's freight we have a good solid traffic base and should be able to maintain operations and remain a viable regional railroad.

The railroad has 21 full-time employees. Work rules are very flexible in that all nonexempt job descriptions cover all railroad crafts. We operate with two-person train crews. The railroad employees are not members of any labor bargaining unit. Without flexible work rules, the Allegheny Railroad could not operate as a viable small regional railroad.

The ICC authorization for the purchase and operation of the railroad as a class III common carrier exempted the company from labor protection. Hammermill's evaluation was that the risk with labor protection would have been about $250,000 per person. Without the labor protection exemption, Hammermill would not have formed the Allegheny Railroad.

Hammermill received excellent support and assistance from the Federal Railway Administration and the Interstate Commerce Commission in planning and launching the railroad. In starting the railroad, however, too many things came together very late in the game. Getting authorization to purchase the railroad and operate it as a common carrier, getting labor protection exempted, negotiating the purchase of the line, getting rolling stock, and developing the organization all come together at the same time, and the key to going forward hinges on the ICC authorization.

I would like to make a point here. I think the 7 days on the ICC thing is great, but it is extremely important where that 7 days fits, whether it is right up when you are forming the railroad or whether it can be back somewhere in the process.

The ability to handle this facet more expeditiously would certainly make the development of a new railroad much easier and more attractive to those interested in entering the railroad business. Particularly beneficial would be having an early decision regarding labor protection, since this becomes a crucial decision point in determining whether to proceed with formation of a small railroad.

The Allegheny Railroad has interchange connections with two major railroads—ConRail and CSX—which gives us greater flexibility in determining how traffic will be routed and we are better able to negotiate division of rates than are small railroads which connect with only one major carrier.

We have a good relationship with our connecting carriers. However, as in any semicompetitive situation, you tend to be at the mercy of the party having the most clout, and in this case that party is certainly the large railroad. Since many small railroads seem to have rather precarious financing, simply the use of delaying tactics by large connecting carriers can force them out of business. Small railroads need some representation in a position of governmental authority to be certain they are getting a fair deal and getting it in a timely fashion. Present competitive forces within the railroad industry are not adequate to simply make this happen.

This concludes our testimony on behalf of the Allegheny Railroad Co. We appreciate this opportunity to present our testimony to the Surface Transportation Committee. Thank you.

[The statement and questions and answers follow:]

Statement of H. LeRoy Weidner, Vice President, Allegheny Railroad Co.

BACKGROUND INFORMATION

My name is H. LeRoy Weidner and my business address is P.O. Box 10050, East Lake Road, Erie, Pennsylvania. I am employed as Vice President of Allegheny Railroad Company and as Director of Corporate Transportation of Hammermill Paper Company, the parent company of Allegheny Railroad Company.

The Allegheny Railroad Company is a regional railroad, 150 miles long which operates between, Erie, PA. and Emporium, PA., and through the communities of Union City, Corry, Warren, Kane, Johnsonburg, Ridgway and St. Marys. (See Map included as Exhibit I). It is a wholly-owned subsidiary of Hammermill Paper Company, an Erie, PA. based forest products company, with annual sales of $2 billion. It commenced operations in September, 1985, following three years of purchase negotiations and the necessary efforts to obtain ICC authorization to purchase the railroad and operate it as a Class III rail freight common carrier. The Allegheny Railroad Company has a freight base of 15,000 carloads per year, which will generate sales of about $8 million per year. It has 21 full-time employees, 5 locomotives, and 250 specialized forest prodcuts hauling railcars. It interchanges with ConRail at Erie and Emporium, with the CSX at Johnsonburg and with the Knox and Kane (a short-line railroad) at Kane.

ORIGIN

The Allegheny Railroad was a Penn Central branch line prior to the formation of ConRail in 1976. At that time, all except 26 miles of the 150 mile long branch line, were included in the ConRail System. The excluded 26 mile segment was purchased by the Commonwealth of Pennsylvania and was operated by ConRail on a subsidized basis.

In about 1981, ConRail applied for and received ICC authorization to abandon common carrier freight service on the balance of the line between Erie and St. Marys, a distance of about 100 miles. In 1985 ConRail applied for and received ICC authorization to abandon common carrier freight service on the remaining line segment between St. Marys and Emporium, a distance of about 25 miles.

Following the 1981 service abandonment, a short line railroad called the JKW&I Railroad Company was formed by local industry to provide rail freight service between Warren, PA and Johnsonburg, PA, a distance of about 50 miles.

When the Allegheny Railroad Company was formed in 1985, it purchased the ownership interest of all parties—ConRail Corporation, Commonwealth of Pennsylvania and the JKW&I Railroad Company—and re-established the entire 150 miles between Erie, PA. and Emporium, PA. as a single, unbroken rail line. ICC operating authority as a Class III rail common carrier was applied for and granted and the Allegheny Railroad commenced operation September 3, 1985.

PURCHASE AND REHABILITATION FINANCING

The purchase funding of the Allegheny Railroad, in the amount of about $5 million, was provided by the parent company, Hammermill Paper Company.

The Allegheny Railroad is currently being rehabilitated to FRA Class III Track Safety Standards (40 MPH) at a cost of about $11 million. Of this amount, Hammermill Paper Company is funding $5 million and the Commonwealth of Pennsylvania and the Federal Railway Administration jointly are funding $6 million.

Hammermill is a capital intensive company in a capital intensive industry. Hammermill does not like to make capital investments in other than its primary business lines, which are paper and forest related products. The total cost of the railroad, including rehabilitation, special railcars, locomotives and other rail related equipment was about $20 million. Without the $6 million of State and Federal funding of the rail rehabilitation program, Hammermill would not have entered the railroad business.

VOLUME AND TYPE OF TRAFFIC

The Allegheny Railroad has a freight base of 15,000 carloads per year. Of this amount, 11,000 carloads represent the parent company's (Hammermill) freight and the remaining 4,000 carloads represent other commercial traffic. Hammermill's freight is pulpwood, wood chips and wood pulp used in the production of reprographic and printing papers. The other commercial traffic includes: refinery products such as butane, fuel oil and asphalt; chemicals; resins; bauxite; liquid alum; lumber and logs. The Allegheny's goal is to maximize the commercial freight capabilities of the rail line and we vigorously solicit the hauling of all available freight. We work with all regional development groups, communities and individual shippers and receivers of freight to maximize the use of rail service throughout the Western Pennsylvania area which we serve. We also work with the Port of Erie, PA. to develop export and import business through the Great Lakes System.

At present, the Allegheny Railroad could not sustain itself and be profitable without the parent company's (Hammermill) freight. With Hammermill's freight, we have a good solid traffic base and should be able to maintain operations and remain a viable regional railroad.

LABOR NEEDS

The Allegheny Railroad has 21 full-time employees. It also draws on the resources of the parent company (Hammermill) in functional areas such as Legal, Accounting, Finance, Tax, Systems, Public Relations, Purchasing and Transportation. All full-time railroad employees are on salary and have benefits including: paid vacations, sick leave, pension plan, health protection plan, long-term disability protection, and a savings plan which includes an employer matching feature.

Work rules are very flexible in that all non-exempt job descriptions-except for office employees-cover all railroad crafts, other than those which require special training, such as locomotive engineer and track inspector. We operate with two-person train crews. The Allegheny Railroad employees are not members of any labor bargaining unit. Without flexible work rules the Allegheny Railroad could not operate as a viable small regional railroad.

The ICC authorization for the purchase and operation of the Allegheny Railroad as a Class III common carrier exempted the Company from labor protection. Hammermill's evaluation was that the risk, with labor protection, would have been about $250,000 per person. Without the labor protection exemption, Hammermill Paper Company would not have formed the Allegheny Railroad.

PUBLIC ASSISTANCE (FINANCIAL AND OTHER)

As detailed earlier in this testimony, Hammermill Paper Company would not have founded the Allegheny Railroad without financial assistance from the State and/or Federal Government. Even being a large, financially sound company, we could not economically justify buying and rehabilitating a railroad without some financial assistance. The ConRail Erie to Emporium branch line, which became the Allegheny Railroad, had suffered 20 to 30 years of maintenance neglect and required a massive dose of rehabilitation funding to return it to a safe operational level. Substantial additional capital will be required to complete the total rehabilitation program and maintain the rail line at the Class III operational level. This should come from the earnings of the railroad.

Non-financial assistance was equally as important in planning and launching the Allegheny Railroad. Hammermill received excellent support and assistance from the Federal Railway Administration and the Interstate Commerce Commission. Without this support we would not have completed the railroad project and purchased the railroad. In starting the Allegheny Railroad, however, too many things came together very late in the game. Getting authorization to purchase a railroad and operate it as a common carrier, getting labor protection exempted, negotiating the purchase of the line getting rolling stock and developing the organization all come together at the same time and the key to going forward hinges on the ICC authorization. The ability to handle this facet more expeditiously would certainly make the development of a new railroad much easier and more attractive to those interested in entering the railroad business. Particularly beneficial would be having an early decision regarding labor protection, since this becomes a crucial decision point in determing whether to proceed with formation of a small railroad.

INTERACTION WITH LARGE RAILROADS

The Allegheny Railroad has interchange connections with two major railroads-ConRail and CSX. Because of this, we have flexibility in determining how traffic will be routed and we are better able to negotiate division of rates than are small railroads which connect with only one major carrier. We have a good relationship with our large connecting carrier. We have a good relationship with our large connecting carriers and wer normally work well together. However, as in any non-competitive or semi-competitive situation, you tend to be at the mercy of the party having the most clout and, in this case that party is certainly the large railroad. Since many small railroads seem to have rather precarious financing, simply the use of delaying tactics by large connecting carriers can force them out of business. Small railroads need some representation in a position of governmental authority to be certain they are getting a fair deal, and getting it in a timely fashion. Present competitive forces within the railroad industry are not adequate to simply make this happen.

This concludes our presentation. On behalf of Allegheny Railroad Company, we appreciate this opportunity to present our testimony to the Surface Transportation Committee.

Thank you.

QUESTIONS OF SENATOR PRESSLER AND THE ANSWERS

Question. What effect does FELA have on small and regional railroads?

Answer. Small and regional railroads could form and operate much easier and economically with Workmen's Compensation than with FELA in that the cost and claims settlement are predictable, fair and less costly. There is a better matching of injury and settlement with Workmen's Compensation and less opportunity to realize an unreasonably large financial settlement.

When a small railroad purchases a total insurance package, which includes FELA coverage, the cost of the FELA part of the package can be 50% to 60% of the total package cost. In addition, FELA claims may have a per accident retention of $25,000 to $100,000 which makes for very expensive protection.

The cost of coverage and expense of FELA settlements places a real financial burden on small and regional railroads. This burden could be reduced substantially, and still be extremely fair to the employee, by requiring Workmen's Compenstion coverage rather than FELA protection.

Question. How do we avoid allowing track to deteriorate to a point of no return, making abandonment the only option? How do we get to these lines before they are run down so far that a short line or regional railroad cannot make a go of them? Is that an objectively identifiable point in the life of a line?

Answer. The point of no return on a line is when it slips below FRA Class I Track Safety Standards. Beyond that point, a total renovation is needed before a workable line can be achieved.

The way to keep this from happening is to strictly enforce the FRA Class I Track Safety Standards and whenever a line fails this standard, the owner has six months to restore it to Class I condition or he must offer it for sale to parties who are interested in continuing rail service on the line.

Senator **PRESSLER**. Thank you very much.

Mr. Hurley, let me say to you that we very much appreciate your good citizenship and your cooperation and the leadership you have shown. We are very lucky to have you working on South Dakota railroad issues.

Mr. Hurley, you and others have mentioned the problems of liability insurance. This is one area in which many smaller lines seem to be at a disadvantage. Let me ask a couple of questions in this area and ask you to elaborate.

How much of an inpact do you estimate that FELA has on your insurance problems? Two, should we repeal or reform it? And three, are there any other insurance-related laws or rules unique to the railroad industry?

Mr. HURLEY. Well, the answer to the first question is that it is somewhat difficult to quantify, but our experience with both the Gulf and Mississippi and with the Dakota, Minnesota, and Eastern have been very similar. The maximum liability insurance that we have been able to obtain is a $25 million limit, with a self-isured retention of $1 million per incident. And the cost of that liability insurance is approximately $800,000 to $1 million annually.

There is no question in my mind that a substantial part of that cost stems from the fact that you have to cover the cost of injuries to employees of the railroad in addition to third party liability situations. Let me also say——

Senator PRESSLER. So basically you have to tie up $1 million?

Mr. HURLEY. That is in premiums. We also have to establish a reserve in the neighborhood of $500,000. Somehow you have to be able to cover that $1 million self-insured retention.

The other factor is that fela lawsuits expose railroads to a very substantial uncertainty. As I mentioned before, you are not dealing with historic data when you attempt to attract investors. You are dealing with forecasts and projections, and the investors must have some confidence in those projections. Any uncertainty tends to make them extremely wary. When there is a potentially very large liability that is totally uncertain, it makes it much more difficult to obtain private investors to invest in these projects.

Second, as to what I would recommend, I cannot see any reason why railroad employees should not be covered by workers' compensation, just as they are in other industries. That may be a simplistic solution, but that would be my recommendation.

As far as other insurance laws, I am not familiar with any that seriously impair the operation of a new regional railroad.

Senator PRESSLER. We are just conferring. There is a vote just occurring on the Senate floor, which means we will have to go and vote and come back. I was going to perhaps keep the hearing going, if you want to go and vote, if you can get back in time—whatever you like.

Senator ROCKEFELLER. OK. I will hurry up.

Senator PRESSLER. Suit yourself. If you are not back, I will just recess.

Ed, should we repeal or reform FELA and what changes need to be made in it?

Mr. HURLEY. As I said, my suggestion would be to cover railroad workers under workers' compensation. This would involve the repeal of FELA. However, if in fact the alternative chosen by Congress is to change FELA, my suggestions would be that you eliminate the joint and several liability feature of it, that a limitation be placed on noneconomic awards, and that some limitation be placed on the contingency fee that is paid to attorneys who represent these clients.

Finally, in my opinion there ought to be some reintroduction of the idea of fault. The concept of fault seems to have disappeared.

Senator Pressler. I might ask any other members of the panel for their comments on that, but I will address this one again to Mr. Hurley.

Much emphasis has been placed on the labor aspects of this issue. Your written testimony does an excellent job of pointing out other efficiencies. Could you elaborate on those and explain how important in relative terms these efficiencies are vis-a-vis labor?

Mr. Hurley. There is no question that it is important to be able to maintain the flexibility in work rules and to get a more effective use of the labor force. But I do think that there is not enough emphasis placed on the fact that the major railroads, like all large corporations, have grown significant staffs. Some of this stems from the need to deal with regulatory requirements, but much of it simply is in the nature of the institution of corporations.

It seems to me that the small railroad or the regional railroad has the opportunity to eliminate layers and layers of management, and they must do that. I think they can make as much a reduction in overall overhead costs as in labor costs.

In addition, I believe that the ability to focus your marketing activities on the individualized service to be provided to the shippers on your line is equally important. I think that there is a tremendous opportunity to increase traffic. This has certainly been true in any of the railroads that we have looked at. We would not have been interested if we did not believe there was a significant potential to incrrease the amount of traffic above and beyond that currently being generated by the class I railroad.

I think the increase in traffic comes about because your traffic and marketing people have a much smaller geographic span to cover, and you can use creative pricing without the fear that it will somehow affect a large system and activities in other areas. You are concerned with running your own business and your own customers. So in my opinion, I think all three of those factors ought to be given equal weight.

Senator Pressler. I know in this room there are many representatives of large railroads and small, and I do not want to set off any sensitivities here, but I expressed concern over the need for a kind of benevolent relationship between the large and small railroads in this area. Is there anything we can do to foster that?

Mr. Haley. Senator, I would like to comment on that from personal experience with the large railroads. First of all, I would like to second Mr. Hurley in his comments. It is not just labor. The productivity in labor that we have obtained is tremendous and very needed. But the marketing has to follow hand-in-hand with the increased productivity in labor. As a point in case, in the first short line I purchased 2 years ago we have taken the originated carloads on the line from 1,400 to 4,000 to 6,000 respectively in 2 years. That is just pure marketing.

In each and every case that reflects an increased cash-flow to the economy because obviously the flow of traffic was because of a better rate. I have talked to so many class I's that I deal with and in most cases the class I railroads look at our railroad as an extension of themselves, and when they look at it that way you point out that—look at me, Mr. Union Pacific, if you will, or whoever, as an extension and I will feed you.

I have found this very helpful in developing very good, sound relationships with the class I railroads.

Senator **Pressler**. I am sure all of you have good relationships. There has been a survey that indicated some are not so fortunate, but that is a very essential thing.

Mr. McCaffrey, do you have anything to say on either the insurance question or the labor question or the big/small relationship?

Mr. **McCaffrey**. Yes, Senator. Thank you.

First, on the insurance question, it should be recognized that there is a distinction in the insurance world between the regional railroads, such as Mr. Haley and Mr. Hurley represent, and the small railroads, such as Mr. Claussen's. The regional railroads have a very limited market for insurance and they are subject to extremely high self-insured retentions. In fact, I think today that a $2 million self-insured retention is the best available in the marketplace, and that means that you pay $1 million for insurance and you are liable for all of the costs of the claim up to $2 million.

Second, the short-line railroads have been extremely handicapped by the lack of insurance. The American Short Line Railroad Association has spent an extraordinary amount of time trying to improve that market. They are hopeful that something can be improved very shortly. The policy available to short lines covers four things—FELA, general liability, cargo bill of lading that is, what is in the freight car—and foreign rolling stock.

The price of insurance is more a function of FELA than any other single element of that package, and yet short lines have virtually no claims. Their loss experience, unlike that of class I carriers, is almost nothing at all, but the insurance marketplace does not make that distinction. I feel that FELA is not applicable to short lines. They are small operations. They should be put under workers' comp laws.

Senator **Pressler**. Say that last sentence again.

Mr. **McCaffrey**. The small railroads in a small locality, that are in the State of Iowa, the State of Minnesota, they should be, like any other business, subject to the workers' comp laws of that State.

Senator **Pressler**. But how do you define small?

Mr. **McCaffrey**. What is small? Well, most railroads, I think you will find, again with the exception of the limited number of regional railroads, are probably in a class between 50 and 200 miles in size. They may span more than one State. It depends.

For example, this Alabama and Florida Railroad, 107 miles, is two lines, probably 50 miles each in length, right at the border. But that is not uncommon for other businesses as well. Trucking companies span borders, and manufacturing companies have facilities in different locations, and the workers' comp laws already take into account multilocation businesses in the coverage of employees adequately for that purpose.

I think FELA, which was adopted in 1908, before workers' comp laws, is a thing that is out of date, certainly as applied to short lines.

Senator PRESSLER. I have a number of other questions for this panel which I am going to submit for the record. Senator Rockefeller said he did not have questions for this panel. By the way, in this whole proceeding other Senators who are members of the committee may have questions to submit in writing for the record.

There are many other things we could cover. I am under a little bit of a time bind here to go and vote, and I hope Senator Rockefeller will open the hearing when he returns. But at this point, while I am gone, if we could get the next panel to come forward: Ms. Claudia Howells, Mr. Ed Immel, Mr. Donald Baker, and Mr. William Tucker—so they will be in the starting chute.

If that panel could come forward, as soon as Senator Rockefeller returns he can start up.

[Brief recess.]

Senator ROCKEFELLER [presiding]. Ladies and gentlemen, we want to resume this hearing now and I would appreciate it if you could take your seats. I would appreciate it if the audience could take your seats.

We are missing one panelist. I take it—it is Claudia who is not here. The State and community panel of our witness list will be Mr. Ed Immel, Rail Planner, Oregon Department of Transportation; Mr. Don Baker, who I will have a word or two about, who is Executive Director of the West Virginia Railroad Maintenance Authority; and Mr. William Tucker, president of the Greater Huron Development Corporation of Huron, SD.

Gentlemen, we are glad that you are here. Who would begin?

STATEMENTS OF ED IMMEL, RAIL PLANNER, OREGON DEPARTMENT OF TRANSPORTATION; DONALD J. BAKER, JR., EXECUTIVE DIRECTOR, WEST VIRGINIA RAILROAD MAINTENANCE AUTHORITY; AND WILLIAM V. TUCKER, PRESIDENT, GREATER HURON DEVELOPMENT CORP.

Mr. IMMEL. Senator, I am going to relate to you the experience the State of Oregon has had with setting up a short-line railroad. We have 12 existing short lines in the State, but most of them originated at the turn of the century. We have had no new short lines. The State's only previous experience that we have had with rehabilitation of trackage has been with the LRSA program and we share your positive views on what it has done in the State of West Virginia. It has been very positive for the State of Oregon.

Since 1980 we have assisted four short-line railroads, and if these rail lines had gone out of business we would have lost 1,600 primary jobs, 3,700 secondary jobs, with a payroll of $86 million. For a State the size of Oregon, this would be catastrophic, and almost all these jobs were retained in a rural economy.

It is safe to say that without the LRSA program we probably would not have had the Lake County Railroad. There is no locally funded planning effort in the State and the ability for LRSA to pay for rail planning made it feasible for the State to assist Lake County.

I should point out that Lake County is in southern Oregon and it is extremely isolated. There are 7,600 people that live in an area the size of the State of Massachusetts, so they are few and far between and almost everybody lives in Lakeview, the only major town. The nearest freeway entrance is 160 miles away, so the city and the county are extremely isolated.

In 1984, the Southern Pacific informed the State that they were going to abandon the line and they said that the 1,100 carloads on the line were not sufficient to let them operate the line at a profit. The traffic in Lakeview consists entirely of wood products. We do not have any grain. We have no coal. But we share the same kind of problems; just the commodity is different.

The mills in Lakeview produce lumber and molding for doorways and windows. They are heavy and most of the markets are a long way from Lakeview, so rail is a natural mode to handle the product. Trucking is not a viable alternative. As I said, we are 160 miles from the nearest freeway entrance, and trucks just do not happen to drop by to pick up a load. It is on nobody's backhaul. In fact, some mills had to wait 3 and 4 weeks to fill a delivery order for truck.

We conducted an in-depth study of the alternatives available to the businesses and, in summary, it was much cheaper for the railroad service to be retained through a short-line railroad than it was to go to any of the alternatives—trucking or reload. However, as the study moved along, so did the abandonment process, but a number of things had to come together, which included the timely meeting of the biennial Oregon Legislature.

Enabling legislation had to be passed which would allow Lake County to get into the railroad business. They had no such authority. It also had to have the authority to operate outside of its normal political boundaries. In this particular case, it had to operate in the State of California. The line originates on Alturas, CA, and three-quarters of the line is in California, although there are no shippers in California.

The other thing we had to do was to find some way to buy the line. The line as a stand-alone private venture just did not make sense. It was marginal. It could probably, we felt, pay its bills, but there was no way to amortize the upfront capital expense and the only way to save it was through a public purchase.

We also had a lottery that came on line at the same time—another one of these fortuitous events—and all the proceeds from the lottery had to be spent on what was termed economic development. So we had to make sure that railroad projects were considered economic development. We found that most State agencies that deal with economic development are familiar with installing sewers, expanding roads, leveling land, but a railroad is somewhat of an unknown and they feared the unknown.

We finally convinced them that yes, Lake County had a good project deserving of funds and the State economic development department released 85 percent of the funds needed to buy the line. The other 15 percent came from the local shippers. We felt this was extremely important because the people who were going to use the railroad had a financial stake in it.

On January 18 of this year, the formal title to the 55-mile line was turned over to Lake County for $550,000 from the Southern Pacific. For better or for worse, Lake County was in the railroad business, the State's first new short line formed from an abandoned segment of a class I carrier.

I must say that the SP was very good to work with, extremely cooperative, and we also found that this was their first venture in a short line that had come from a former SP branch line. So we kind of felt our way through all of the regulatory maze and anything else. We shared a lot of common problems.

The county did not want to operate the railroad themselves, so we went through a bid process and we got the Great Western Railway of Colorado to be the operator of the line. Five weeks after the line started operating, heavy rains hit northern California. The line washed out in 23 places. We had three major slides and a bridge went out. We felt this was not a good start for a short line. However, the line was restored to service and, with the assistance of an LRSA emergency grant, most of the damage is being repaired.

I should point out as an practical point that since Lake County has taken over the line carloadings have increased dramatically. By May of this year there were 40 carloads a week on the line, while the SP experienced only 25 carloads weekly prior to the transfer of ownership. And this is due to several major things. One of them, the shippers now have a financial stake in the line. If they decide to go with an alternative mode of transportation they are actually taking money out of their pockets. Since their surcharge could go up.

The line is headquartered in Lakeview, which means its service is improved. Before, it took 3 days to move a car in Lakeview because the Southern Pacific, where they were headquartered, had to travel 90 miles, one day, down from Klamath Falls, tie up overnight, then had a day to go up and back again, tied up overnight again in Alturas, and then another day to return to Klamath Falls. So three days if you wanted to move a car 100 feet. Now it is a telephone call and 15 minutes later the general manager or one of the employees are down there to move the car.

The other thing we found was that the railroad was cheaper and the businesses understand that and they are supporting it. They also realize it is in their long-term interest for them to support it, because if it goes under there is probably going to be nobody that is going to come in and buy the line. We do not as a State policy want to subsidize the operation of the line.

Why is it making money? We felt there are several reasons. One of them is the marketing aspect of it. Also, we have two-man crews. The Southern Pacific had five-man crews and they had a caboose. We have no craft lines. The general manager is also the conductor and the engineer maintains his locomotive. We are also paying salaries equal to that in the lumber mills. We are not paying minimum wage. We are paying, for Lake County, very good salaries.

We have in fact taken over some of the SP employees who voluntarily came with the line. We are starting a new line, which started about a month ago, in which the contract with the Southern Pacific says that SP employees have hiring preference, and we expect to be hiring several of them.

We have had liability insurance problems. We do not handle certain types of commodities because we cannot get the insurance for it—hazardous material, such as propane, which is something we could handle, and instead is handled over the highway from a reload point off the Southern Pacific.

In closing, the Department feels that our experience with the LRSA Program shows that deferred maintenance is the greatest problem of that any short line faces, whether it is an existing short line or a new one that is being created from a class one carrier.

We have, through the LRSA Program, been able to work with communities. We may have a couple more that spring up in the State, but at the same time we also are realistic enough to know that not every line is a potential short line railroad. Some of them, frankly are dogs, and we recognize that.

So I think it is important that we have the ability to assist the communities, and in some cases we have the ability for a private operator to maintain service. Right now the State has funds to buy a line, but we have no locally generated funds to assist in rehabilitation.

We feel that the LSRA Program has been extremely important, especially in the case of Lakeview, where we were able to repair the flood damage. So the dollars from the LRSA Program have not only helped the railroads but have also helped us and the State maintain a planning function in order to address the abandonment problems in the State of Oregon.

Thank you.

[The statement follows:]

STATEMENT OF ED IMMEL, RAIL PLANNER, OREGON DEPARTMENT OF TRANSPORTATION

My name is Ed Immel and I am the Rail Planner for the Oregon Department of Transportation. Today I want to relate to you an experience the State of Oregon has had in the setting up of a shortline railroad. The example I will use is the former Southern Pacific Railroad branch from Alturas, California, to Lakeview, Oregon—a distance of 55 miles. Before I begin the saga of Lakeview, I would like to quickly recap the involvement the department has had with rail issues in the state.

In 1978, the department obtained its first funding for rail projects when the Federal Railroad Administration began the Local Rail Service Assistance (LRSA) program. Since that time, LRSA funds have allowed the state to engage in rail planning and provide assistance to short lines in communities. Unlike many other states, Oregon cannot spend gas and other highway generated revenues on anything but the construction and maintenance of roads. The Constitution of the state will not even allow highway taxes to pay for the operation of the state patrol, let alone rail planning.

The LRSA program has provided assistance to a number of short line railroads around the state. (A summary of this assistance is attached.) Without this assistance, most of these rail lines would have gone out of business and approximately 1,600 primary and 3.700 secondary jobs would have been lost along with an estimated payroll of $86 million. In a state without that many jobs to begin with, the effect would have been catastrophic, especially to the small rural communities in which the majority of these jobs are located. It is safe to say that without the LRSA program, Lake County would not have been able to obtain the railroad and protect the 220 jobs involved. The planning efforts funded by LRSA made the difference between having a project and line abandonment.

LAKE COUNTY'S RAILROAD

In 1984, the Southern Pacific told the state that they were looking at a plant rationalization program and one of the lines that was considered redundant by the railroad was their branchline from Alturas to Lakeview. The 1,100 carloads generated by the lumber mills in Lakeview were not sufficient to allow the railroad to operate the line at a profit and they were going to begin abandonment proceedings the first part of 1985.

Lake County is one of Oregon's most isolated areas. The 7,600 citizens of the county reside in an area the size of the State of Massachusetts, while the nearest interstate freeway entrance is 160 miles from Lakeview.

The four lumber mills in lakeview are located over 1,000 miles from their California markets and are over 2,000 miles from their important mid-western customers. Most of the woodchips produced as a by-product must travel 492 rail miles to their destination. Lake County clearly suffered from a lack of viable transportation alternatives-truckers just did not stop by to pick up a load. Mills had to wait three and four weeks to fill a truck delivery order due to lack of trucks.

The Oregon Public Utility Commissioner met with the community and the shippers to plan the ICC protest to the abandonment. Oregon DOT at the same time began to provide some alternatives to the loss of Southern Pacific service. The first step was to conduct an in-depth analysis of the line, where the traffic moved, what the cost of alternatives to rail service would be, and a list of possible courses of action that were available to the community and the shippers. The study also measured the impact the loss of rail service would have on Lake County. Jobs lost would total 220 jobs while payroll impact would be $5 million less out of a total county yearly income of $45 million.

The state's Intergovernmental Relations Division provided Lake County with a block grant to hire a consultant to do much of the background work needed to develop the alternatives. Since none of the shippers were locally owned, it was necessary to provide a spreadsheet format whereby the corporate office could examine the impact each of the solutions would have on the cost of the product they produced. The analysis showed that going to a shortline operation was the cheapest alternative available. The community was so isolated that direct trucking was not viable. In fact, some mills had to wait three and four weeks to get a truck in to get a shipment out. Markets for the lumber products produced by the mills were located in southern California, Arizona, Texas, and the east coast. All of these areas were expensive to handle the product by long-haul trucks. In addition, the woodchips generated as a waste product by the mills had their only market in the Portland area which is 350 miles distant. For environmental reasons, these woodchips could not be ground dumped or open burned. The distances involved also made trucking of woodchips less than a viable alternative.

As the study moved along, so did the abandonment proceedings. A decision had to be made soon as to whether or not the community was willing to buy their own rail line. Obtaining funds obviously was one of the major problems. However, a number of things came together at the same time including the timely meeting of the biennial Oregon Legislature.

Lake County had no authority to own and operate a railroad, nor could they own and operate a line that even lay outside of their jurisdiction in another state. The Legislature passed enabling laws which allowed a variety of public bodies, including port districts, counties, cities, and the state to purchase, own, and operate a rail line inside and outside of their own political boundaries. At the same time, a possible source of funding for rail projects, such as the purchase of the line at Lakeview, was being discussed in the Legislature at the committee level.

Oregon had a new lottery in which the proceeds where, by statute, reserved for economic development projects. The department support attempts to make rail projects eligible for funding by the state's lottery. While the Legislature continued their discussion and final passage of the necessary laws, the abandonment proceeding before the ICC was drawing to a close and in October, the Southern Pacific was granted a certificate to abandon service. It was realized that a suspension of service would make the restarting of the line as a short line an extremely difficult proposition. The Southern Pacific agreed to continue operation of the line as long as discussions were proceeding towards the acquisition of the line. To make a long story short, the lottern funds were eventually granted to Lake County for the purchase of a rail line. The final selling price for the line was $550,000, which was considerably less than the $1.2 million sought by the Southern Pacific. However, working together with the Southern Pacific, the continued traffic generated by the line and interchanged with the Southern Pacific provided a monetary incentive for the railroad to negotiate in good faith for the lower selling price. For the Southern Pacific, it proved to be a learning experience also. Lakeview turned out to be the first SP branchline that eventually evolved into an independent short line.

Lottery funds provided 85% of the purchase price with the remaining 15% supplied on a equal basis by the shippers located in Lakeview. In the meantime, an operator selection process was underway since Lake County did not want to operate the railroad they owned. Eventually, Great Western Railway Company, which has operations in Colorado, was chosen as the designated operator of the line.

On January 18th the formal transition of the line from Southern Pacific ownership to Lake County was highlighted by ceremonies in front of the Lakeview depot. For better or for worse, Lake County was in the railroad business and the State of Oregon had its first new short line formed from an abandoned segment of a Class I carrier.

Operations began immediately by great Western and there was no gap in rail service provided by shippers in Lakeview. However, an intensive look at the condition of the trackage revealed the deferred maintenance which the line had experienced in the last years of Southern Pacific ownership. Five weeks after the line started operating devastating floods struck the northern California and southern Oregon area washing out the railroad in 23 places, bringing three major slides down upon the tracks and one bridge was washed away. The future of the railroad looked bleak. However, Great Western Railway had faith in the future of the line and proceeded to reopen the line with a combination of their own funds and a loan from Lake County. Within a period of 10 days, railshipments resumed and the line was back in service. However, the cost to the rail line in financial terms was great. Application was made to the Federal Railroad Administration for emergency funds under the LRSA program to repair the damage that the railroad had sustained during the period of flooding. The Federal Emergency Management Agency also responded with funds to assist in the restoration of service on the segment of line in California. The Federal Railroad Administration's emergency grant has enabled the railroad to repair the damage it sustained from the storm and will return the operation of the line to a more normalized maintenance schedule. It is safe to say that the FEMA funds in California and the emergency LRSA funds have allowed the railroad to continue in operation. Without them, the future of the line could be bleak.

Since Lake County has taken over the ownership of the line from Southern Pacific, carloadings have increased dramatically. In May, 1986, carloadings had increased to almost 40 a week—a substantial increase over the former 25 carloads experienced by the Southern Pacific. The carloading increase can be attributed directly to the renewed interest the shippers have in the line and the personalized service the new short line operator is able to provide. The short line operator has been able to bring an economy to the operation that was never possible under Southern Pacific ownership. Today train crews consists of an engineer and a conductor, rather than the engineer, fireman, conductor, and two brakemen which operated the Southern Pacific train. When the crews are not operating trains they are assisting in maintenance of the physical plant and equipment. Where before, the Southern Pacific had no employees located on the line in the State of Oregon, there are now eight people paying taxes and purchasing goods and services in Lakeview. The railroad pays local mill wage rates to its employees. Most important, however, is the ability to use employees in different jobs rather than be straightjacked by rigid work rules which allow no crossing of trade or craft lines. At the same time, some Southern Pacific employees are still working on the mainline trains and maintaining the trackage over which these trains roll rather than being laid off since the carloadings did not revert to truck but instead remained on the railroad.

The departments' involvement with the Lakeview Railroad has provided the experience necessary to assist other communities facing the same type of loss of. rail service. At the present time, the department is working with the Port of Tillamook Bay to acquire an 85-mile branchline which operates from a suburb of Portland over the coastal mountain range to the Pacific Ocean and the mills at Tillamook. The department is also providing assistance to shippers on the Bailey and Westside Branches which face abandonment by the Class I carrier.

The experience gained from the Lakeview operation has also displayed some weaknesses in the state's approach to the rail problem in the state. The department feels that there should be state funding of rail projects from lottery proceeds, however, the focus should be changed from the purchase of lines to assisting the lines with rehabilitation. Our experience with the LRSA program has shown that deferred maintenance is the greatest problem faced by short lines whether they already exist or ones which may emerge from those segments Class I carriers no longer find profitable. The decision to purchase a rail line, it is felt, should be made on the local level.

The rail program in the state is far from being secure. Infrastructure lottery funds are limited and the competition for the dollars is fierce. At the same time the state finds much of the branchline trackage susceptible to abandonment.

In closing, the department through the LRSA program has gained valuable experience in dealing with shortline rehabilitation and branchline operations. Again, without LRSA funding it is doubtful there would be much of a rail planning effort in the state. The success of the LRSA program in Oregon is evidence by the viability of the shortlines assisted and the retention of the jobs in the communities they serve.

Senator **Rockefeller**. Thank you very much.

Don Baker is the executive director of the West Virginia Railroad Maintenance Authority, which has a relatively long history going back into the 1970's and is, I think, quite an interesting effort on the part of the State of West Virginia, and in the case of the South Branch Railroad a very, very successful one.

Don Baker has done a variety of things in his, what I would call, public career, but it has been mostly on the private side of things. He has been very helpful in community development, not only to the county from which he comes, Hardy County, but also on an area basis.

Now, of course, he is executive director of the statewide authority and a real leader in West Virginia on economic fronts in general and railroad matters in particular.

Obviously, I welcome you here, Don Baker, and I am very interested in your comments about the local Rail Assistance Program, the problems that you faced, and the difference that LRSA made to you, and to the South Branch Railroad, not only in its planning but its rehabilitation, now with the flood having devastated so many bridges and trackage areas.

I think of the 51 miles on the South Branch Railroad, there is only about maybe 9 or 10 which are actively in use now because of the devastating floods, and so you have many burdens, and perhaps you would care to share a few with us.

Mr. **Baker**. Thank you very much, Senator. I appreciate the kind words.

It is an honor to be before the committee today, and I would like to outline somewhat the transfer of the South Branch Valley Railroad from the Chessie System to the State of West Virginia; go over a little bit the demographics on the railroad, how we operate it; and then make some general points about several of the items that you mentioned.

South Branch Valley Railroad is a former B&O branch that extends from Green Spring in Hampshire County in the eastern Panhandle southward 51.4 miles to Petersburg in Grant County. It also goes through Hardy County, of which Moorefield is the county seat.

Similar to the line in Oregon, the railroad provides the one method of bringing in bulk commodities to the South Branch Valley. We do not have an interstate that runs either north and south or east and west; therefore, if we are to bring in bulk commodities for the poultry industry as well as some of the other industries, it is necessary to come in by the South Branch Valley Railroad.

In 1978 when the railroad was acquired from the B&O, it was done so rather uniquely. The B&O donated the line to the State of West Virginia. As you well know, you were the Governor at the time and received the deed from Chairman Hayes Watkins in a ceremony right here in the U.S. Capitol Building that was arranged by Senator Byrd.

The line was an integral part of the B&O's Deferred Maintenance Program that had existed for about 25 years. As you well know, when the line was taken over it was in very bad condition. They had made the decision that it could not be operated by them, and therefore it would have to be abandoned.

After much thought and consideration by the State, it was decided that it was in the best interest of the valley and the approximate 1,200 jobs that were directly or indirectly related to the railroad that it should be preserved.

After acquisition in 1978, the railroad maintenance authority considered three different options to operate the line, one being the leaseback to the B&O, one being a lease to a short line operator, a third being State operation itself. Without going into great details, the avenue that was chosen was State operation, and that is currently the way it is being operated.

As with the short line in Oregon, we operate with two-man crews. We have a maintenance crew that maintains the line, as well as a crew that maintains the rolling stock that we have. Traffic on the railroad itself runs slightly over 1,000 cars per year. Most of our traffic is inbound traffic for the poultry industry.

We are the recipient of a State operating subsidy that has fallen every year since 1978. Our goal, of course, is to be completely self-sufficient, and we have every reason to believe that that is possible. Most of that is tied to the growth of the poultry industry.

Our line is a little bit unique for West Virginia in the fact that no coal runs over it. It is primarily, as you said, poultry and grain products that come in. We have shown in the past quite a bit of growth in the poultry industry. It continues to expand, and we are hopeful and we have every reason to believe that within the next 5 years there will be another major poultry integrating firm to locate somewhere on the South Branch Valley Railroad. We came very close in 1983, but because of some problems not really in West Virginia but in another State, the firm chose to locate elsewhere.

They were, however, very impressed with West Virginia and the programs that we had in industrial development and the fact that we were committed to trying to save the line so that they could have service.

As you said, the flood of 1985 was very devastating. It has taken a lot of the work that we have done and literally washed it down the river. We feel, though, that with the assistance of the Federal and State Governments that has been committed to the line that we will be able to rebuild and continue with the expansion that we had before.

Right before the flood, we had upgraded the line to a class 2 standard, and that brings in one of the key elements of the South Branch story. Had it not been for the Local Rail Service Assistance Act and the millions of dollars that were put into it, there is, in my estimation, no way that that line could have been rehabilitated to the extent which would have been necessary for it to have even had a chance.

I think that is the key. Once local communities determine that a rail line can be rehabilitated and should be kept, then I think that it is the role of the local, the State and the Federal Governments to all come together to insure that the line at least has a chance. That, for us, has been the chance that we had through the Federal money and in the Local Rail Service Assistance Act.

I understand what people say when they say that it should be a State role. Well, I can say that for the State of West Virginia we participated in that role for the three counties through which the line runs. They participated, and the Federal Government participated.

I think that if we are going to keep the rail infrastructure in this Nation, we are going to have to continue that partnership. None of the three, the local nor the State nor the Federal role can abrogate to the others. I feel very strongly about that.

Again, it is a real pleasure to be here. There are other things that I have said, technical parts about the railroad, that I have included in my testimony, and I will certainly be willing to answer any questions.

[The statement follows:]

STATEMENT OF DONALD J. BAKER, JR., EXECUTIVE DIRECTOR, WEST VIRGINIA RAILROAD MAINTENANCE AUTHORITY

My name is Donald J. Baker, Jr., I am the Executive Director the West Virginia Railroad Maintenance Authority (WVRMA). I very much appreciate the opportunity to testify before the Surface Transportation Subcommittee on the U.S. Senate Committee on Commerce, Science and Transportation on the subject of the creation of new railroads. The WVRMA is somewhat unique in that it is the owner of what we believe is the only purely state owned and operated short line railroad in the nation, that being the South Branch Valley Railroad. The purpose of my testimony is to give background information on this railroad, how it came to be created, what funds were expended to rehabilitate it and subsidize its operation, what it means to the area it serves and what its future might be.

INTRODUCTION

The South Branch Valley Railroad (SBVR) is a 51.4 mile line-haul railroad owned and operated by the West Virginia Railroad Maintenance Authority (WVRMA), the designated agency for statewide planning and promulgation of rail projects. The SBVR serves the communities of Petersburg (Grant County), Moorefield (Hardy County), the Romney (Hampshire County), and connects with the B&O at Green Spring on the West Virginia-Maryland border.

While about 31 other small railroads are owned wholly, or in part, by states or local municipalities, the SBVR is atypical in that it is entirely operated with state employees. The SBVR is also unique because it was given to the State of West Virginia by an operating railroad. On October 11, 1978, in an elaborate ceremony in that nation's capital hosted by then Senate Majority Leader Robert C. Byrd (D-WV), Chessie Chairman Hays T. Watkins handed over title to the property to West Virginia Governor John D. (Jay) Rockefeller IV. In accepting the deed, the Governor stated that "the line serves a poultry feed mill at Moorefield and keeping it could save some 1,200 jobs." the state accepted the SBVR with guarded enthusiasm. The RMA Chairman welcomed the takeover at two days of festivities in Moorefield by stating that "with the help of the good Lord, we will make this railroad a success." Thus, West Virginia became both an owner and operator of a rail line.

Other unique features of the SBVR transfer are that this was the first time a railroad had donated a rail line to a state, and that the SBVR was going to be a West Virginia railroad which did not carry any coal.

THE TRANSFER FROM CHESSIE

In 1970, the Chessie proclaimed the South Branch line to be a deficit operation and announced intentions to file for abandonment. The threat of abandonment provoked strong opposition from the Governor of West Virginia and local industrialists who contended that the South Branch line was essential to the prevervation of existing industry and vital to the economic development of the communities it served. The filing was initiated in 1975.

Other events of the seventies had a direct bearing on the SBVR's evolvement as a state-owned and operated railroad. With the 3-R Act and the creation of Conrail, many unprofitable branch lines became candidates for abandonment. While most of the lines targeted for abandonment were located in other states, West Virginia became directly involved when the USRA called for discontinuance of service on a portion of the Charleston, West Virginia-Columbus, Ohio line. While this particular segment of the Charleston-Columbus line was in poor operating condition, it was nevertheless considered an attractive area for potential industrial development. The threat of the loss of rail service over this line, above everything else, led to enactment of the West Virginia Railroad Maintenance Authority Act in 1975, and to the creation of the WVRMA, effective February 1, 1976. (Prior to that time, no rail planning agency existed in the state). The Act granted broad authority to the WVRMA, including: (1) the right to impose eminent domain; (2) the right to own rail properties in other states; and (3) freedom from constitutional prohibition against state financing of private industry.

The Authority consists of seven members—six of whom are appointed by the Governor who is, himself, a seventh ex officio member of the board.

Following its filing for abandonment of the South Branch line in 1975, (later withdrawn), the Chessie again filed on October 28, 1976. By this time, the 4-R Act was before Congress, and political pressure again forced Chessie to recall its abandonment proposal. The WVRMA, ably supported by the political clout of West Virginia Representative Harley O. Staggers, Sr., was beginning to exert its influence.

By 1977, it had become evident that the South Branch line, which was beginning to show promise of traffic gains, would survive only under a program of joint federal-state assistance. The WVRMA contracted with Ford, Bacon & Davis, transportation and engineering consultants, for an engineering and economic analysis of the line. The study, which was completed in June 1977, presented the following conclusions and recommendations:

1. The operation of the line should become profitable within five years.
2. Carloadings and revenue reached a low point in 1976 and should show an increase for the next several years.
3. Rehabilitation to FRA Class II and upgrading to a 263,000-pound limit is not economically justified at present.
4. Abandonment of rail service on the line would have serious adverse socioeconomic effects on the residents of Grant, Hardy and Hampshire Counties.
5. Abandonment of rail service would have negligible impact on the environment.
6. Profitable operation of a short line on the South Branch would require a very favorable division of revenue with the B&O.

Based on these conclusion, the following recommendations were made:

1. If a Certificate of Convenience and Necessity permitting abandonment of service on the South Branch is granted by the ICC, the Authority should offer rail service continuation payment to the B&O.
2. The Authority should explore the division of revenue which a short line operator could negotiate with the B&O based on actual traffic.
3. The Authority should work to ensure that shippers on the South Branch receive an adequate supply of cars so that increased car loadings could be realized.
4. The Authority should reexamine the economic feasibility of rehabilitation to FRA Class II and upgrading to a 263,000-pound limit at such time as the line becomes profitable.

The findings of the study confirmed the opinions of the WVRMA and became a clear mandate for the state to become more deeply involved in preserving service on the South Branch. Finally, in 1978, the Chessie gave the 51.4-mile South Branch line to the State of West Virginia. On October 11, 1978, Chessie Chairman and President Hays T. Watkins turned over the deed to the former B&O South Branch from Green Springs to Petersburg to Governor John D. Rockefeller IV.

Even before the historic transfer of the line had been consummated, the WVRMA held a series of meetings between October 1977 and April 1978 to evaluate various options under which the SBVR could be operated. The Chessie estimated that annual operating losses would approximate $650,000. The Authority's estimate was in a more moderate range of $350,000–$400,000.

The State attempted to find an operator for the line and reviewed 40 possible applicants; these included a manufacturer, two officials of short line railroads, one local merchant, one operator of other short lines, and one contract manager of city transit systems.

All applicants were found to be deficient in some area, mainly because: (1) the recovery of equipment capital costs by a private operator would inhibit the state's cost control and audit responsibilities (this type of short coming has damaged state operations in other states); (2) some proposals did not provide for a management-level decision-maker on the railroad property; and (3) some qualified applicants were unwilling or unable to comply with the bureaucratic maze required for federal assistance. Given that shippers along the line clearly viewed state operation as most favorable, on April 1, 1978, a unanimous decision was adopted by the WVRMA providing for the state to operate the SBVR.

OPERATIONS

The principal industries served by the SBVR are located in the valley towns of Romney, Moorefield, and Petersburg, all county seats. The rail line, which traverses the 4-5 miles-wide valley of the South Branch of the Potomac river, runs from its stub-end at Petersburg to the B&O connecting point at Green Spring at the Maryland State line. About 95 percent of SBVR's traffic is inbound. Agri-business and light industry are the primary industries of the South Branch Valley is the largest poultry area in the state. In fact, the region's poultry business ranks in the top 20 nationwide and is expected to continue to expand.

The principal companies presently served by the SBVR include Rockingham Poultry Cooperative, Inc.; the Allied-Egry Division of SCM Corp., a printing plant; Adell Polymers, a plastics plant; Appalachian Explosives, an explosives manufacturer; Kingsford Charcoal, a charcoal manufacturer; and Alleghany Wood Products, a quality hardwood producer. The fully-automated, computerized Rockingham feed mill alone provides feed for a poultry operation that employs over 400 people. Another further processor of poultry relying heavily on Rockingham is Hester Industries, Inc. which also employs almost 500 people. They are just completing a $5 million expansion that will employ another 200 people when finished. Despite the threat of abandonment of the South Branch Valley line, Rockingham, in 1975, announced plans for a major expansion program to include the high-volume feed mill. In April 1975, Governor Arch A. Moore, Jr., in a letter to Rockingham's president, assured the company "the State will, with the guidance and assistance of the United States Railway Association, take necessary steps to insure continuance of the line." The feed mill was completed in 1977 as the first phase of their expansion. Another expansion in 1979 doubled production to a present level of 28,600,000 broilers processed each year.

The SBVR handles about 80 percent of Rockingham inbound shipments, all of the incoming paper traffic and 15 percent of outbound traffic for Allied Egry, 50 percent of inblund pellets for plastic molding used by Adell Polymers, and incoming raw materials for Aappalachian Explosives and Kingsford Charcoal.

Products emanting primarily from these five plants, and the raw materials they use, accounted for nearly all of the 1,036 of freight handled by the SBVR in 1985. Inbvound traffic predominates at each station and is expected to account for an even larger share of total carloads in the future.

The SBVR owns five locomotives—four GP-9 road units and one 600-HP switcher. Other equipment owned by the SBVR includes a tamping machine, two Hi-Rail tractors (with attachments for tie insertion, ballast spreading, and material handling), a bulldozer, a 100-ton side-dump car, a 25-ton crane, a flatbed truck, a dump truck and two pickups. The SBVR also owns two flat bed and four hopper cars that are used in work service. Most of the SBVR's work equipment was obtained with federal funding. In addition, the state appropriated funds for the erection of a small locomotive repair shop and office building on a 13-acre tract at Moorefield. All except heavy repairs are handled in the shop, and all SBVR as well as WVRMA are performed in the Moorefield office.

While car supply and locomotive power on the SBVR are adequate, the woeful condition of the right-of-way was a serious problem. When the WVRMA took over the operation of the road in 1978, it was faced with a massive rehabilitation problem. The last end-to-end track rehabilitation and bridge repair program had been undertaken by the B&O 30 years earlier in 1948. During the span of years from 1970 to 1978, the B&O track force reportedly consisted of one foreman and two men (with one pickup truck) for the entire 51 miles of line. Only those repairs were made that would enable the line to operate.

In the fall of 1978, the Authority, with a firm resolve to attack all of the bad spots, ordered an end-to-end inspection of the plant. The inspection revealed that 60 percent of the ties were in need of replacement. On April 4, 1979, the Authority initiated its track rehabilitation program—at that time, the SBVR was averaging one derailment per week. By late August, some improvement was noted and the frequency of derailments declined to one every three or four months. Since the summer of 1979, the Authority has spent approximately $4.8 million in track rehabilitation. The Authority's ultimate goal was to raise the line to Class II standards except for a speed threshold necessitated by track curvature.

Bridges were another major problem on the SBVR, in particular two steel bridges that were limited to a 70-ton loads. This presented both a cost disadvantage and car supply problem. These two bridges, which were built in the 1880's, were dismantled in 1910 and moved from the B&O's lines in Ohio to their present sites. In all, there are 53 bridges on the SBVR including five termed as large by SBVR management—the two steel bridges and three consisting of timber and steel.

An aggressive bridge rehabilitiation and maintenance program resulted in raising the weight limits of all bridges on the line to a 100 ton limit effective April, 1983. This effort was essential if the line was to retain its largest customer which needed that load limit in order to remain competitive with other poultry firms.

The Authority achieved the goal of raising the line to Class II standards in August, 1985 by completing a surfacing, lining and tamping program begun the year before. This followed a complete ballasting of the entire line. Replacement of defective joint bars further insured the viability of the 25 miles per hour, 100 tone limits that were needed.

The remaining work that needs to be accomplished is the replacement of worn out rail. Approximately four miles of 105 pound relay rail have been installed with another four miles on hand waiting to be installed.

One major goal that was achieved was the extension of rail service into the Grant County Industrial Park. This one mile extension was built in 1985 by SBVR forces with funding provided by the Appalachian Regional Commission, the Grant County Commission and the WVRMA. This effort landed a new shipper, Allegeny Wood Products as well as created a new transportation mode for a previously unserved industrial park.

PERSONNEL

The SBVR has reduced the level of employment since the years when a great deal of rehabilitation work was accomplished. The goal has been to operate and maintain the line with the number of people that a normal short line would need. Presently, staffing for the SBVR is as follows:

Position:	*Number*
Executive director	1
Operations manager	1
Clerks	3
Track workers	11
Track supervisor	1
Train operations supervisor	1
Train operating technician	1
Shop superintendent	1
Mechanics	2
Electrician	1
Total	23

All personnel are employees of the state. The Executive Director of the WVRMA is both the head of the state agency as well as the chief operating officer of the railroad. All supervisors are working supervisors. Employees are non-union, covered under the West Virginia Civil Service System. Freedom from union constraints enables SBVR management to control labor costs and provides for employee diversification. For example, the operating personnel listed above perform track work on the days trains do not run. Conversely, some personnel from the track and shop are certified operators who can perform the duties of engineer and conductor. Two people is the normal size of the train crew. No caboose is used in train service unless unusual circumstances would dictate its necessity.

FINANCES

As noted previously, substantial funds have been provided the SBVR by both the state and federal governments. However, diminishing resources from both have forced a major effort to cut expenses while continuing to upgrade the line and maintain service. Below is a comparison of the revenues and costs of the SBVR for the first year of operations and the most recent one:

	1979	1985
Railway operating revenues:		
Freight	$306,441	$305,317
Demurrage	71,490	12,380
Miscellaneous	16,165	10,439
Total operating revenues	394,096	328,136
Railway operating expense:		
Train operations	605,398	241,229
Equipment and track maintenance	161,255	349,460
General and administrative	246,251	188,143
Depreciation		188,143
Total operating expenses	1,012,808	911,990
Operating (loss)	618,808)	(583,854)

As can be seen, the actual, out of pocket loss suffered by the SBVR in 1985 is $395,711 because of depreciation. This represents a dramatic decrease in cash subsidies that must be paid by the State of West Virginia. Of course, with an improvement in operating efficiencies gained from an improved track bed, such progress should be expected. It is anticipated that expenses for track and equipment maintenance should begin to decrease since most of the rehabilitation work has been completed.

It should be noted that, had it not been for the availability of federal funds through the Local Rail Service Assistance program of the Federal Railroad Administration, the rehabilitation of the SBVR would not have been accomplished very easily. Even with the state legislature's commitment of funds for operating subsidies and track improvement, the federal dollars were the key ingredient. Total federal funds received since 1979 amount to $5.4 million.

INTERACTION WITH OTHER RAILROADS

The SBVR connects with only one major railroad, CSX Corporation at Green Spring, WV. As noted previously, the SBVR was a former B&O branch line. Generally speaking, CSX has been very cooperative in their dealings with the SBVR. Their recent efforts to sell marginal branch lines has created more of a willingness to try to insure the success of those lines that can feed them interchange traffic that might be too expensive to pick up and deliver themselves. That, combined with the fact the SBVR is a unique attempt to make a short line viable through public sector ownership as well as operation is an incentive to be cooperative. With the advent of contract rates, CSX also seems more willing to discuss the divison of revenues sufficient to make the SBVR viable. While some progress has been made in this area, much has to be done if the SBVR is to survive either in the public or private domain.

FLOOD OF 1985

After the major rehabilitation work was completed in August 1985, a devastating flood in November 1985 destroyed or severely damaged a substantial portion of the SBVR. The estimated 500 year flood destroyed four major bridges and damaged approximately thirty four miles of track. The railroad qualifies for federal flood assistance through the Federal Emergency Management Agency which will provide funds to rebuild the line. We are in partial operation over the northernmost nine miles of track that were undamaged. A transloading facility has been set up to be used by our customers until full service can be restored. We are confident of being able to maintain enough service to retain our shippers until we regain full operations.

CONCLUSION

When the State acquired control of the SBVR in 1978, the attitude of the new management was one of "guarded optimism." That same attitude prevails today.

The South Branch Valley has been economically strong, even through the recent hard times suffered by the state in general. The Valley does not have an interstate highway going through it in either direction. Because of this, the SBVR is the most economic method of hauling bulk commodities. The West Virginia Legislature, combined with two different administrations, has supported continuation of rail service to the area because of its economic impact. Efforts by management to reduce the SBVR's dependence on both the state and federal government is an attempt to justify this continued support.

The annual WVRMA Board review of the future of the rail line is one which, by Board agreement, alternatives of operation of the rail line by others would not be seriously considered until the total track/bridge rehabilitation program was completed. Furthermore, the Authority has determined that the state will not, under any alternative, relinquish ownership of the properties, and would, if contracting with another operator, insist on a continuation of the maintenance and service levels it has established.

Advantages the WVRMA enjoys in operating the SBVR, when compared with private ownership and operation, are listed below: Access to federal surplus equipment; No federal or state taxes or local real property tax; State agencies as sources of procurement and other services; Access to state funding; Authority to invoke eminent domain; Close rapport with state and local economic and marketing development organizations; Authority to issue revenue bonds for railroad purposes; and Low interest rates and first choice at operating other abandoned light density lines in West Virgina (Contingent upon future legislative action)

While there are certain inherent disadvantages in operating railroad by a state agency, most are outweighed by the benefits. The chief disadvantage is the perception that the state should not be in a business that has traditionally been run by the private sector. If progress continues in the manner it has over recent years, the chances of the line once again being operated by the private sector are reasonably good.

Very clearly, the story of the SBVR is one of a three way partnership working to save jobs and retain the economic base of an area. The local governmental and development groups fosters industrial growth that depends on the SBVR for its existence. The state and federal governments provided funds for track rehabilitation and operating subsidies. Without this partnership working closely with each other, it is doubtful rail service could have been retained.

The attitude of our state could best be summarized from a quote by John Killoran, former Executive Director of the WVRMA. He said, "West Virginia believes that local rail service to industry is as important as good highways which have always been a major governmental priority. Our industrial development program has featured technical assistance to rail matters for years. While the public always thinks of roads as the top use of scarce tax dollars, they often fail to understand that lack of proper rail facilities might deny them jobs. The South Branch Valley Railroad is unique, but is our chosen method of saving a thriving region of our state from economic calamity, and assuring a dynamic future to the area."

Senator **PRESSLER** [presiding]. Mr. Tucker, from my State of South Dakota, we welcome you here from the city of Huron. I shall be in South Dakota this weekend in another part of the State, but I am glad to see you are here.

Mr. **TUCKER**. Thank you, Senator Pressler. I represent the local development corporation called the Greater Huron Development Corp. Of course, our particular interest is our location on the new Dakota, Minnesota and Eastern Railroad.

There have been some references earlier in testimony about geographic isolation. I think we can give you a lesson in geographic isolation for the whole State of South Dakota has approximately 700,000 people. We are central in location to approximately 500,000 of those people in the eastern part of the State.

Our development corporation represents approximately 250 square miles in the middle of the State of South Dakota. We are about an hour from the East-West and North-South interstate. We are very definitely tied to an agribusiness environment.

The location of Huron is both a strength and a weakness. While it is geographically isolated, it is also very much a market center. Ironically, in the State of South Dakota, an outside evaluator has recently given it the most favorable business climate of the 48 contiguous States.

One of the things that we need to maintain that competitive edge as a favorable business climate, of course, is rail service. Also being tied to an agribusiness environment, we are very much in need of diversification of our economic base. In that diversification, we contact industries daily for expansions and relocations. It is a very common requirement that there be rail service.

For the local farmer, the railroad gives the shipper's market options. In our location, various research that has been done at the South Dakota State University estimates that the difference is between 11 and 28 cents per bushel if it shipped by rail as contrasted with truck shipments.

We feel in our area that the short lines may be more responsive to the markets and that in some respects the long line carrier that we have had has really not worked it. As someone referred to earlier, I am not sure they really want it to be there.

We do anticipate the short line operator as wanting to be there, and we are delighted that similar lines have been successful elsewhere.

One of the concerns expressed has been that related to the impact of labor. Beadle County, in which we are located, for the most recent month that I have available statistics had an unemployment rate of 3.2 percent. For the State of South Dakota, we had an unemployment rate of 4.1 percent.

Now, the average wage paid in nonagricultural industry in South Dakota ranges from $6.50 to $7.50 per hour, depending upon which part of the State you are looking at. Skilled labor is competitive in our area at $8 to $10 per hour.

We do not believe that the Dakota, Minnesota and Eastern Railroad will be in a position in our area to exploit workers. We would like to maintain our competitive business edge with the short line rail service, and we intend in our area to work with them to see that they are successful. We think it is a very important aspect of economic development in our region.

Thank you.

[The statement follows:]

STATEMENT OF WILLIAM V. TUCKER, PRESIDENT, THE GREATER HURON DEVELOPMENT CORP.

The Greater Huron Development Corporation is concerned about economic development throughout our region. Our region may be described as follows:

Huron, South Dakota is a community of approximately 13,000 people located in Beadle County, South Dakota. Beadle County has a population of approximately 19,000 persons. The community is located in the East Central part of South Dakota in the valley of the James River. Huron is the center of the States population. Approximately one-half million South Dakotans live within a two and one-half hour autombile drive from Huron. The population in a twenty-five mile radius of Huron is estimated to be 23,000 and the population for a fifty mile radius of Huron is somewhat over 70,000 people. The area surrounding Huron is agricultural land with a preponderance of grain farming and cattle raising. Huron is situated in an agri-business economy.

Huron could be considered geographically isolated. The community is 575 miles west of Chicago; 292 miles southwest of Minneapolis; 380 miles south of Winnipeg; 185 miles south of Jamestown, North Dakota; 630 miles northwest of Denver; 120 miles northwest of Sioux Falls, South Dakota; and 600 miles west of Milwaukee, Wisconsin. The location of Huron in this agricultural environment is key to our economic viability. Huron is a market center. The industrial community reflects the environment.

Our lending industry is meat packing with three separate companies in operation and the principal manufactured products are meat products feed and seed products. In recent years the community has attempted to diversify the economy. Currently, we have an industrial park that is filled. There are now several manufacturers in Huron producing digger derricks, coal mining machines, concrete products, plastic products, beverages, steel products, sewing products, mill works and electronic components. Because of our heavy reliance on the agricultural community we continue to concentrate our efforts to diversify our economy. As we seek new industry and expanded industry, a common request is for rail service.

South Dakota, in general, and Huron, in particular, takes advantage of the highly favorable business climate in the State. During the past two years the Grant Thornton Company has rated the South Dakota business climate as the most favorable among those of the forty eight contiguous states. Among the factors contributing to a favorable business climate, transportation has to be a significant concern. The community has good highway access being situated at the crossroads of U.S. Highway 14 and State Highway 37. This places us approximately one hour from both east-west and north-south Interstate Highway systems. Huron also has the third longest airport runway in the State and a relatively new and modern airport facility.

While this testimony is focused on the Huron area, the points could be modified to include other areas proposed to be served by short line rail.

Good railroad service is no less important than any other mode of transportation. For example, South Dakota corn can be shipped to more distant points when the railroad is available. And the direct benefits to producers and shippers is estimated to be somewhere between eleven and twenty eight cents per bushel. Also, soybeans are being shipped farther by rail and the volume of oats and wheat moving by rail has increased in recent years.

The principal benefit of rail service is the opening of market options. Now shippers can choose for best price among several shipping destinations. This may not be available without the railroad because of prohibitive shipping costs.

In November, 1985, the Chicago and North Western Transportation Company announced that they were negotiating with the L.B. Foster Company to sell most of their track in South Dakota as well as some in North Dakota and Minnesota. Now the purchase is imminent and a new short line railroad named the Dakota, Minnesota and Eastern Railroad has been formed to operate this railroad system.

The South Dakota population density decreases west of Huron along the Dakota, Minnesota and Eastern (D,M, & E) Railroad and farming practices reflect reduced rainfall. The State Capitol at Pierre, near the geographic center of the State, is located on the Missouri River, which essentially divides the State into East River and West River. West River is essentially range land until the D,M, & E Railroad reaches the Black Hills at Rapid City. Rapid City is a population center for the Black Hills. And, this region has valuable wood products, cement, bentonite and other minerals to be transported.

The line north of Huron serves agricultural communities, including the State's third largest city of Aberdeen, and continues through agricultural communities to Oakes, North Dakota.

East of Huron the the D,M, & E Railroad passes through progressively more productive farmland and branches off to the fourth largest community in the State, Watertown. Watertown has vigorously pursued industrial development and many manufacturers are located there. The line then extends east into more densely populated Minnesota farmland and cities to the Wisconsin border at Winona, Minnesota.

Over the years the heavily regulated railroads have had competition from other forms of transportation. By the 1970's one fifth of the nation's rail trackage was in some form of bankruptcy. In 1980, Congress eliminated many of the regulations by passing the Staggers Rail Act. Since that time, we have observed healthier railroads and improved service elsewhere. May we, too, have the opportunity for the short line system to operate here.

This D,M, & E short line railroad system is a most welcome alternative to the proposed "abandonment" of at least part of this line. We have information that the L.B. Foster Company has been successful in other short line rail operations. I believe that the presence of the new railroad will help us to maintain competition in the cost of transportation as well as remain competitive in the marketing of our products. We believe that the short line railroad may be healthier financially than if the same service was provided by the Chicago and North Western Company. The new railroad company will, because of scaled down size, be able to be more sensitive to and more responsive to the markets. And, because the new railroad could operate outside of existing union rules, operating costs could decrease.

The South Dakota Department of Labor provides regular data on employment for the State and for the counties. In April, 1986, our Beadle County unemployment rate was 3.2%. The unemployment rate during the same period throughout South Dakota was 4.1%. With this low rate of unemployment in this area, we are confident that the new railroad will be required to pay competitive salaries for qualified persons in their employ. This is not to say that the present unions salaries and worker rules will continue to exist. Rather, it is likely that new work conditions will prevail. Salaries for skilled workers in this area are competitive in the $8.00 to $10.00 per hour range. The railroad simply will not be in position to exploit this labor market.

In summary, in the Greater Huron Development Corporation, we are delighted at the prospect of having a new railroad operating as a short line railroad that will help us keep our competitive edge in maintaining our highly favorable business climate. We anticipate an aggressive partnership with our new railroad in continuing to promote economic development in our area.

Clearly, if the new streamlined approach to short line railroad operation is successful in maintaining railroad service here, the concept should be applicable to other similar situations.

Senator PRESSLER. Thank you very much.

I was out of the room during part of the testimony because of a vote on the Senate floor. I must ask Bill Tucker from Huron, first of all, you did mention the labor issue. You have heard much concern expressed over the labor issue this morning. How has labor reacted to the new railroad in South Dakota, in your judgment?

Mr. TUCKER. Senator, the railroad labor community has had an opportunity to anguish over this for quite a long time because we have been talking and fearing abandonment.

In the context of abandonment, I suppose there has been a wide range of response on the part of the labor community, ranging all the way from panic to serious concern. I think that that particular concern has softened to the point where recently the idea of a shortline railroad is being welcomed, albeit somewhat reluctantly, because it is a less desirable option than being affiliated with a mainline carrier, but I believe there is an eagerness to get on board and serve the shortline carrier.

Senator PRESSLER. Mr. Baker, I understand you testified that CSX donated to the State of West Virginia its rail line. I am very intrigued with that.

Is this a totally unique situation, or has this been done elsewhere? Is there any way to encourage the class one railroads to make such donations? What shape was the line in, and what do you estimate its value to be?

Mr. BAKER. When the donation was made, Senator, I was not working for the Railroad Authority at the time; however, I was in a role similar to this gentleman. I was an industrial developer in the area.

It is my understanding that it is the first time that a railroad was ever donated to a state. Senator Rockefeller, then Gov. Jay Rockefeller, was the one who orchestrated that and was able to go on the good graces of Chessie and get them to do that.

To answer your other questions as to what shape it was in, it was in very bad shape. Maintenance had been deferred on it for a number of years. The B&O saw it as early as 1970 as probably not a branch line that was going to have a future in the long-term development of the Chessie, the B&O system.

As I said, they did donate the line. What the value of the line at the time, what Chessie showed on their books as the value I do not know. Since that time, there have been a substantial number of funds put into it, probably both State and Federal dollars, around $5 million, to rehabilitate it. Of course, a lot of that work was wiped out with the flood in 1985.

As far as encouraging other railroads, I would not be optimistic that a lot of railroads would want to do that, simply from the fact that they, like every other business, would like to get as much out of it as possible, and simply salvaging 51 miles of track could be of considerable value.

In this instance, however, it was approached in such a different and unique manner that I think Chessie saw it as one of the first opportunities to keep the traffic but not have to come up the valley and get it. That was the State's commitment to going in and seeing that it would work. It was more of an incentive to them.

I really think that it was one of the first lines where Chessie started doing this idea of wanting to keep the interchange traffic and not having to do up the branch to get it.

Senator **Pressler**. Now, there is some talk that it is obviously preferable for shortline and regional railroads to work out their problems with connecting class one railroads through negotiations. There are going to be times, however, when this fails, and the big railroads may or may not negotiate.

Do you believe the ICC's existing rules are sufficient to protect shortline and regional railroads against joint rate cancellations or other problems? I give that to anyone.

Do you think that, if the going gets rough, the small railroads are going to be treated fairly without some—I hate to use the word reregulation, but without some rules?

Mr. **Immel**. Senator, I think in the case of the Lake County Railroad, we only interchange with one carrier, the Southern Pacific. They have been excellent to work with in the ratemaking area. When we first went to get the railroad, they said that they were going to give no division of rates on wood chips, which is a major commodity for the line, and we got $225 a car. So I thought they bent quite a ways.

Also, on lumber we were able to negotiate the rates so that we do have a considerable amount of income from traffic that we interchange with the Southern Pacific.

I think the Southern Pacific also realizes when they had the line they were only getting 25 carloads a week off the line. We are now getting 40 carloads, and that is 15 more cars that they are able to haul over their railroad. So as long as that increase in business continues or they maintain it, I think it is in their own economic self-interest to keep the traffic on the line.

If the Southern Pacific wanted to unilaterally cancel and just say we do not want to give you anything or any of the traffic, however, we would have that waiting time for the ICC, and they could make their statement, but at the end we may still end up with having absolutely no revenue at all. So I do not think there is a real good safeguard at this time.

Senator **Pressler**. Senator Rockefeller.

Senator **Rockefeller**. Thank you, Mr. Chairman.

Mr. Baker, in your testimony you referred to some of the points that Senator Pressler raised. When the railroad was taken over by the state, and it remains to this day the only State-owned, State-operated railroad in this country, if my memory serves me correctly the average speed that a train could travel on that track was about 5 miles per hour, am I not correct?

Mr. **Baker**. That is correct.

Senator **Rockefeller**. Were you not averaging about one derailment per week at the time of the transfer from Chessie?

Mr. **Baker**. Yes, sir.

Senator **Rockefeller**. Then the State went ahead and spent about $4.8 million over a period of years to not only work on some of the bridges but also the rail track itself, which was in deplorable condition.

In fact, I think you pointed out in your testimony that there really had been no end-to-end rehabilitation of the track since 1948, which at that time was a 30-year deferred maintenance program by the Chessie System.

So when John Riley, as the administrator of the Federal Railroad Administration, says that the Local Rail Assistance Program is not necessary, I strongly disagree with him. I mean, I agree with what you have said, and that is that the State has put in a lot of money, that the people of that area have put in a lot of money, but that you could not have made it with LRSA.

The South Branch Railroad, the 1,200 jobs, the poultry industry, the other industries that are there now, the expansion into one industrial park, none of these things could have taken place without a very small, modest amount of money that came from the Federal Government and a program that nobody has heard of but which is basic to those three counties, called LRSA, the Local Rail Service Assistance Program.

Now, Mr. Riley said that the States can pay for this. He said that there is no more fat available in the Federal Government, which in and of itself is an interesting statement. He said the States have the money to pay for this.

Do you agree with him?

Mr. **Baker**. West Virginia did not. West Virginia had money to help operate the line, but I think that is one of the things that people are a little bit confused about. I think there is money there to acquire a line, because if a railroad will not be willing to donate it, they will be willing to sell it for a reasonable price. I think that most railroads have been reasonable in what they would like to buy the line for.

So in my opinion, that is not the problem. The problem then becomes will that railroad have an opportunity to succeed by having rehabilitation dollars. West Virginia contributed. They put money into that line. They put money into operations. They put money into making sure that it could have a chance to succeed while the Federal moneys were being used to rehabilitate the line.

I would also say that the Federal Railroad Administration and the people that we have worked with through the LRSA Program have been very cooperative and very helpful, Mr. Riley's own department. So it is not a criticism of them, but it is just a philosophical difference that I have.

I agree that it would be extremely helpful for the scores of small branch line railroads that are going to come into existence. I think that is a given. They will come into existence, and I really wonder if a lot of these railroads, for the South Branch Valleys of the world and for the areas in Oregon and in South Dakota, if those lines will have a chance if there is not some sort of Federal involvement; not total Federal involvement but, once again, the partnership that I was talking about.

Senator ROCKEFELLER. Philosophically, then, you would agree that it may be, as Mr. Riley said, that there are some requests for that Local Rail Assistance money which perhaps could be funded by other sources, but there are states like West Virginia, there are situations in this country where an area is wholly dependent upon for its economy a short line railroad such as the South Branch Railroad in West Virginia, and that there are circumstances where the local community and the State cannot afford to put up the money to operate on a continuing basis or to rehabilitate at the time of obtaining the railroad, and that that Federal money, a very small amount of money, is absolutely crucial.

There may be cases where people can argue, well, they do not need it. There may be some States or some communities where they could afford it, but there are communities where it is essential, and it has to happen, and the only way we can have that money available is to protect that program.

Mr. BAKER. Yes, I agree with that. That has been our experience.

Senator ROCKEFELLER. This program has been diminishing. Senator Pressler and myself engaged in substantial guerrilla warfare to try and keep it. I mean, we were on the same side to keep it from being obliterated, because it is one of those programs nobody has ever heard of. It is one of those things that could be dropped so easily, and there is no constituency for it. Yet, you could not be operating that railroad with State employees without the work of LRSA.

Mr. BAKER. That is correct, in my opinion.

Senator ROCKEFELLER. Thank you, Mr. Chairman.

Senator PRESSLER. I might say the same thing applies in South Dakota.

Senator Rockefeller, you have done a terrific job in working on saving some of these funds. There may be additional questions for the record, and there is also some testimony from Oregon which will be placed in the record.

Senator PRESSLER. We thank this panel very much.

At this time, we will call our last panel, which is Andrew F. Reardon, senior vice president, law, ICG Railroad; Mr. John Sweeney, senior vice president, corporate affairs; and Mr. O.M. Berge, chairman, Railway Labor Executives' Association.

Mr. Reardon.

STATEMENTS OF ANDREW F. REARDON, SENIOR VICE PRESIDENT—LAW, ICG RAILROAD; JOHN SWEENEY, SENIOR VICE PRESIDENT, CORPORATE AFFAIRS, CSX RAIL TRANSPORT, ACCOMPANIED BY PAUL R. GOODWIN, SENIOR VICE PRESIDENT, FINANCE AND PLANNING

Mr. **Reardon**. Thank you, Mr. Chairman.

I have a prepared statement which I wish to have read into the record.

Senator **Pressler**. Without objection, it will be printed in its entirety. If you can summarize the highlights, we will place all your statements in the record.

Mr. **Reardon**. Thank you, Mr. Chairman.

In addition to that, I would like to summarize that statement, and I am also prepared to address any questions which you and other members of the committee might have.

By way of summary, the rail mergers which have occurred in the late 1970's and early 1980's were occurring all around the Illinois Central Gulf Railroad, primarily on an east-west orientation, and in response to that, ICG engaged in a rather exhaustive analysis of its future and concluded that its future really lay in the viable core line traffic from Chicago to the Gulf of Mexico.

To that end, we elected to dispose of many of our east-west lines, and in 1985 we really commenced the bulk of that disposition program, starting with the sale to the Gulf & Mississippi to which Mr. Riley alluded earlier. That sale of trackage involved approximately 700 miles of track.

In December 1985, we engaged in another major sale to the Chicago Central & Pacific Railroad, also consisting of approximately 680 miles of track. That encompassed our line from Chicago to Omaha.

In 1986 we continued that program with a sale to Mid-South Rail Corporation of the line from Shreveport, LA to Meridian, MS.

We continue to engage in those programs. We have additional trackage now under contract.

We believe that the regional railroads have clearly favored the regions they serve by means of a personalized service, tailored to individual customers, and with labor efficiencies, they continue to assist the viability of the local economy. Basically they have accomplished what the major trunk carriers have found most difficult, and that is providing a relatively short haul on a profitable basis.

Consequently, we believe that the growth of the regional railroads by means of these line sales will become an increasingly significant part of the American railroad industry and will be critical to the welfare of the employees, the shipping public, and the communities which they serve.

Mr. Chairman, I would like to emphasize four key points in my summary. First, with regard to the formation of these regional railroads which now comprise almost 25 percent of the railroad industry in terms of employment, we think it is an extremely favorable development in terms of the competitive ability of the industry.

Second, the trunk carriers which sell these lines and the regional carriers which purchase them remain mutually interdependent. Unlike the sale of a factory or a piece of engine where it is tail lights down the highway, if you will, following consummation of the transaction, we do not take that view at all. We have a continuing interest in the viability of those regional carriers.

Specifically, at ICG, we maintain to this day 60 percent of the interline traffic from those regional roads. By way of example of what we do to cultivate that relationship, when we engage in a line sale transaction, we send in a so-called SWAT team which consists of marketing and accounting experts, the function of whom is to not only facilitate a smooth transition, but more importantly, to ensure a long term, ongoing, viable operation of the regional carrier.

Third, line sales to regional railroads are clearly in the best interests of the employees. Specifically, sales of marginally profitable and unprofitable railroads are far superior to abandonments where in fact all jobs are lost. In the average ICG line sale, 77 percent of the affected employees are employed by the new railroad, and those who are not so employed are typically offered very attractive severance packages.

I might comment that interestingly enough, 10 out of our first 11 line sales resulted from abandonment applications, so that the choice between sale and abandonment sometimes can be very close.

Thirdly, the new employer-employee relationship under FELA is something which has improved, we believe, under the Regional Line Sale Program. The FELA statute, which was alluded to several times this morning, is clearly an outmoded statute and applies both to the regionals and to the trunkline carriers as well. It was also suggested that the regionals should go to a workmen's comp method, and I would suggest that in principle that applies to the trunklines as well.

Fourth and finally, the imposition of labor-protective conditions are not in the best interests of either the regional carriers or the employees. Those conditions dramatically decrease the economic attractiveness of the sale of these raillines and the economic attractiveness of the investment in these raillines. And in fact, we believe they would work a rather cruel irony upon the employees because while designed to aid the employee, they would in fact tip the economic scales from a line sale transaction to an abandonment transaction. And that is not in anybody's best interests.

Mr. Chairman, the ICG appreciates the opportunity to present its views to you and the committee this morning and would welcome the opportunity to address any questions which you might have.

[The statement follows:]

STATEMENT OF ANDREW F. REARDON, ILLINOIS CENTRAL GULF RAILROAD CO.

My name is Andrew F. Reardon. I am Senior Vice President-Law and Real estate of the Illinois Central Gulf Railroad Company [ICG]. My business address is 233 North Michigan Avenue, Chicago, Illinois 60601.

ICG was created in August, 1972 as a 9,691-mile railroad as the result of the merger of the Illinois Central Railroad Company and the Gulf, Mobile & Ohio Railroad Company. As of May 31, 1986, ICG operated 4,034 miles of railroad in mid-America, extending generally from the Great Lakes to the Gulf ports of New Orleans, Louisiana and Mobile, Alabama. ICG serves the states of Illinois, Indiana, Missouri, Kentucky, Tennessee, Mississippi, Louisiana and Alabama. We are a major transporter of grain, grain mill products, chemicals, paper and forest products, coal, trailer and container traffic.

ICG's experience with sales of railroad lines dates back to 1974 when it sold it 68-mile line west of Natchez, Mississippi in Louisiana to Louisiana Midland Railway Company. One year later, ICG sold its 168-mile line between Columbus and Greenville, Mississippi which it had acquired from the former Columbus & Greenville Railway at the time of the ICG-GM&O merger in 1972.

During the next 5 years from 1975 to 1980, ICG made no line sales. From the middle of 1980 to the middle of 1984, ICG sold eleven separate line segments totaling 470 miles to shortlines after receiving orders from the Interstate Commerce Commission authorizing abandonment of ten of the eleven line segments.

Attachment A hereto is a list of all of ICG's line sales which have been consummated to date.

Prior to 1984, ICG's principal method of rationalizing its system was through abandonment of railroad lines which, in a few instances, were purchased by shortlines created by shippers or by local communities interested in continuing rail service to their plants or communities.

By way of historical background, the commencement of the so-called "new shortlines" occurred in the East with the bankruptcy of the Penn Central and rlated rail lines and the subsequent abandonment of thousands of miles of rail lines in the northeast quadrant. This development then spread westward and continued with the financial crises of the Rock Island and Milwaukee Road which had a dramatic impact upon the Midwest. As the ICG and others operating in the Midwest and South continued to rationalize their systems, interest in establishing regional railroads has increased significantly. Shippers, investors and communities have joined together in establishing and supporting regional railroads. The diminished regulatory burden also has facilitated this development. In particular, the Interstate Commerce Commission has aided this development by granting a class exemption in Ex Parte No. 392 (Sub-No. 1) effective February 17, 1986 which permits a noncarrier to acquire a line of railroad by filing a seven-day notice with the Commission. This expeditied procedure has facilitated line acquisitions by nonrail carriers and eliminated unnecessary regulatory burden and related legal fees.

While indeed, creation of regional railroads in some instances represents a step toward a region's economic survival, there are significantly more positive attributes to the formation of these regional carriers other than mere survival. Regional carriers can accomplish what the trunk carriers find most difficult: the providing of rail service over short distances on a profitable basis. Due to local ownership and control, carload shippers and intermodal customers get hometown rail service at competitive prices. The regional operators provide local shippers with a car supply tailored to their individual needs together with customized plant sevicing, switching and interchanging.

There is a striking and perhaps ironic parallel in the formation of these regional railroads in the early years of railroading in this country. Specifically, the creation of the fledgling regional by the Class I railroads is a unique regeneration: while both the early railroads and the new regional railroads were formed because of economics, the creation of the former was prompted by economic growth and the latter by economic survival.

ICG's activities in reationalizing its system to a heavy-density core system have gone beyond the creation of the so-called "shortlines" and have led to the creation of several regional railroads within the last 2 years, some of which are rather substantial in size.

To gain perspective as to the underlying rationale for the ICG line sales, one must appreciate that the ICG and the entire railroad industry is in a state of transition. The effects of the megamergers in the industry have placed significant economic pressure upon ICG's ability to provide rail transportation service at a profit. In particular, due to the fact that the major mergers have been largely oriented in an east-west direction, significant volumes of traffic are now routed around ICG east-west trackage, dramatically reducing the profit margins of operations of many of those east-west ICG rail lines. In 1982, prior to the major ICG line sales, ICG's revenues decreased $138 million from 1981 to a level of $905 miliion. In 1983, revenues declined still further to $881 million resulting in a loss of $16 million for the year. Because of a reduction in ICG operating expense including a 34% reduction in its work force and a 39% reduction in management employees starting in early 1982, ICG experienced a return to profitability in 1984 and 1985. All of the foregoing developments have led ICG management to conclude that our efforts and resources should be concentrated upon the core line traffic from Chicago to the Gulf. This required the elimination of the unprofitable and marginally profitable ancillary lines which have subsequently become the subjects for sale to regional carriers which can operate these lines on a more profitable basis. At ICG we firmaly believe in the viability of the core line which is a major link in the nation's transportation network from Chicago to the Gulf. However, with equal firmness we believe that the viability of that core line is threatened in the event that the ICG were to be unable to engage in sales of other parts of its system to regional carriers. If the opportunities for such sales were to be reduced or eliminated, not only would ICG investors suffer, but also ICG employees, the shipping public and the communities we serve would also be adversely affected.

The major portion of the ICG line rationalization program involving the new regional carriers commenced in July, 1985. In that month, we completed the sale of 713 miles of track in East Mississippi and Alabama to the Gulf & Mississippi Railroad, which was formed by the L.B. Foster Company. On December 24, 1985, we sold our lines from Chicago west to Omaha, Nebraska and Sioux City, Iowa, 674 miles, to Chicago, Central & Pacific Railroad Company. The principal owner of the Chicago, Central & Pacific is John E. Haley, an investor who is also the owner of the Cedar Valley Railroad, which bought the 109-mile ICG line between Mona Junction, Iowa and Albert Lea, Minnesota on September 20, 1984, shortly after ICG filed an application to abandon the line.

On March 31, 1986, we sold our Meridian, Mississippi to Shreveport, Louisiana line, plus a line to Gulfport, Mississippi, a total of 280 miles, to MidSouth Rail Corporation. We presently have a contract to sell our Paducah to Louisville, Kentucky line, 305 miles of railroad, to C,G&T Industries, Inc.

The equity financing for the sale to Gulf & Mississippi Railroad was furnished by L.B. Foster and L.F. Rothchild. The debt financing was provided by General Electric Credit Corporation, which also provided the debt financing for the sale of our Iowa lines to Chicago, Central & Pacific Railroad Company. The Meridian, Mississippi to Shreveport, Louisiana sale to MidSouth Rail Corporation was financed by a banking syndicate headed by the First Bank of Boston.

In the area of labor relations, the regional railroads together with the rail labor unions appear to be in the vanguard of future industry relations. With the increase in productivity, profit sharing plans and elimination of antiquated work rules, the regional roads have been able to succeed where candidly, the trunk lines have failed. Clearly the regional roads have brought to our industry a fresh and productive approach to be shared by employers and employees alike.

One of the advantages which regional railroads have over Class I carriers is the ability of the former to negotiate work rule changes with the labor unions. Large railroads have simply not been able to accomplish this. This ability is critical for continued operation of a lighter density line of railroad. As a result, the regional roads can operate this type of line more efficiently in many instances than can the trunk railroads. Almost universally, the regionals are able to negotiate with the unions smaller crew sizes. Some of the regional lines which have negotiated labor agreements such as the Chicago, Central & Pacific Railroad Company and MidSouth Rail Corporation have been able to negotiate away the old rule that 100 miles of travel earned a day's pay. This type of antiquated and expensive wage level, which after exhaustive negotiations has recently been increased to 102 miles per day for Class I railroads, virtually eliminates any hope for profit on a short haul of a few hundred miles. In place of such anachronisms are profit sharing plans and the so-called "401(k)" savings plans to which employers and employees contribute. For example, at present, the employees of the Gulf & Mississippi Railroad and the employees of the Chicago, Central & Pacific Railroad are participants in profit sharing plans; the Midsouth Rail Corporation has a 401(k) savings plan for its employees.

The regional railroads have also been able to negotiate with fewer unions than have the larger railroads. For example, the Gulf & Mississippi Railroad employees are now covered by six unions, whereas, under ICG's ownership there were thirteen separate unions. The Chicago, Central & Pacific's union contract includes a new position called "master journeyman". This is a combination of three job categories: machinist, electrician and car repairman. By way of specific example, under ICG's ownership of the line, if a headlight was burned out on a locomotive, the bulb could only be changed by an electrician; under the Chicago, Central & Pacific Railroad contract, any "master journeyman" can perform this task.

Work rule changes, including the reduction in crew size, clearly permit these regional carriers to operate more efficiently with the ability to establish competitive rates and provide better service to their customers.

In this regard it should be understood that the fundamental economics which attract outside investors to purchase and operate these regional railroads are clearly enhanced by the absence of labor protection requirements. Labor protection would adversely affect most if not all of these lines sales to the point where abandonment becomes economically superior to sale of the line. Ironically, the imposition of labor protection, although intended to assist employees, would be the very element which would mandate abandonment and resulting unemployment.

Another positive phenomenon which we observe from the operation of regional railroads is that the payout for personal injuries at this point in time appears to be less than the payout by the trunk line carrier operating on the same trackage. We believe that this will be particularly significant where the regional railroad has a profit sharing plan such that personal injury payouts serve to reduce the profits. As you are aware, the railroad industry is not covered by state workmen's compensation laws but rather is operating under a negligence statute such that when an employee injury occurs, the employee oftentimes files a lawsuit against the employer under the Federal Employer's Liability Act. Because of the litigious nature of our society, aggressive pursuit of legal business by attorneys and the fact that this statute unfortunately pits the employee against his own employer, the payout is exorbitantly high. In fact in 1986, we expect that the FELA personal injury payout in the industry will eclipse $300 million. Unfortunately, this is borne by the public who ultimately pays for it in the form of higher shipping rates, etc. Here again, where a profit sharing plans adds to the sense of cohesiveness between an employer and employee, spurious claims and unreasonable demands for injuries are avoided and litigation is minimized because the employee and the employer are working toward a common goal, the sharing of "profits."

Regarding employment on the regional railroads, former ICG management employees and scheduled employees were hired by most of the regional roads to operate these new companies. The Gulf & Mississippi Railroad hired 207 ICG scheduled employees; the Chicago, Central & Pacific Railroad hired 409 ICGs scheduled employees; and MidSouth Rail Corporation hired 278 ICG scheduled employees. Collectively, those three regional roads hired about 77% of ICG scheduled employees who operated the lines before the sale. Also, Chicago, Central and Pacific hired 63 ICG employees who were furloughed or were otherwise not working at the time of the sale. The creation of these regional railroads has served to preserve jobs on light density lines which would otherwise have been abandoned in whole or in part.

ICG's corporate goal is to reduce its operations to a 3,000 mile north-south core system by the end of 1987. Sales to regional railroads will permit ICG to reach that goal earlier than anticipated. In addition to reaching these goals, line sales are critical to ICG's ability to survive. The lines sales enable ICG to maintain traffic flow from the regions which the new regional railroads serve; hence ICG continues in a partnership with the regional railroads and has a continuing business interest in their prosperity. On the average, ICG continues to handle 60% of the traffic generated by the regional railroads.

For communities, shortlines offer continued service for shippers and receivers, the opportunity for economic development and the preservation of jobs and the tax base of the communities. Regionals have the ability to provide transportation service in areas where Class I railroads can no longer operate profitably and in many cases are a substitute for abandonment.

It should be emphasized that the labor economies achieved by the regional railroads have been achieved not merely by a reduction in wages but most importantly by a more efficient utilization of labor in the form of elimination of antiquated work rules and antiquated job classifications. Although in some cases wages have been reduced, we anticipate that due to the profit sharing and 401-(k) savings plans, the average regional railroad employee will in the long-term, actually experience an increase in overall earnings. Clearly, this result together with a continued stable economic environment of the areas served by such regional railroads is far preferable to abandonment of the subject rail lines.

At ICG, we encourage the planned development of regional railroads free of any inhibiting conditions such as labor protective conditions because we believe that if left to the free market, this form of rail transportation will continue to be a growth industry in the distribution network of tomorrow.

[ATTACHMENT A]

ILLINOIS CENTRAL GULF RAILROAD CO. LINE SOLD TO SHORTLINES

Line description	Miles	Date consummated
1. Vidalia to Pacton, LA	68	Mar. 13, 1974.
2. Columbus to Greenville, MS	168	May 22, 1975.
3. Ordill to Mande, IL	8	May 9, 1980.

ILLINOIS CENTRAL GULF RAILROAD CO. LINE SOLD TO SHORTLINES—Continued

Line description	Miles	Date consummated
4. Freeport, IL to Madison, WI	59	Feb. 2, 1981.
5. Herscher to Barnes, IL	63	July 19, 1981.
6. Columbia to Silver Creek, MS	29	Dec. 16, 1981.
7. Rosedale, MS to Airport Switch	32	Dec. 31, 1981.
8. Oxford, MS to Grand Jct., TN	55	Feb. 14, 1982.
9. Princeton to Wilson, KY	103	Mar. 9, 1982.
10. Cairo to Elco, IL	18	Apr. 24, 1983.
11. Dyersburg, TN to Hickman, KY	52	Sept. 29, 1983.
12. Cisco to Green's Switch, IL	14	May 25, 1984.
13. Carroll to Kenton, TN	37	Aug. 12, 1984.
14. Mona Junction, IA to Albert Lea, MN	109	Sept. 20, 1984.
15. Cleveland to Hollandale, MS, Metcalf to Leland, MS, and Greenville Airport to Greenville, MS	64	May 9, 1985.
16. East Mississippi Lines	713	July 9, 1985.
17. Chicago, IL to Omaha, NE and Sioux City, IA	674	Dec. 24, 1985.
18. Lula to Lyon, MS	19	Dec. 31, 1985.
19. Indianapolis to Sullivan, IN	117	Mar. 18, 1986.
20. Meridian, MS to Shreveport, LA	418	Mar. 31, 1986.
21. Browns, IL to W. Henderson, KY	51	May 6, 1986.

Senator PRESSLER. Mr. John Sweeney, senior vice president, CSX Rail Transport.

Mr. SWEENEY. Mr. Goodwin will deliver a brief summary of our testimony, and I will add a few comments at the end.

Mr. GOODWIN. Thank you, John, Mr. Chairman, Senator Rockefeller. We look with favor upon the recent developments taking place in the shortline industry for a number of reasons. First of all, they permit the industry an opportunity to increase its return on assets. Second, they help preserve rail transportation by permitting significant improvements in local service, as many have testified this morning. Additionally, they do so within a sound financial framework which employs private capital.

We do not believe that these divestitures are de facto abandonments or sham transactions. On the contrary, they permit enhancements of assets which might otherwise be headed for abandonment had the transformation of operations not been made possible by the sales transaction.

By and large, these transactions involve lines which are viable but less productive and requiring more capital than the private sector will support without some restructuring. Although shortlines are restructured operations on the subject property, they are not an attack on unions. The vast majority of workers are unaffected, and the employees involved in the transactions generally favor the transaction. Basically, the divestiture is purely a capital productivity question.

Early returns indicate that these efforts lead to revitalization, with many publics well served. Employees on the new lines are pleased, shippers receive better service, localities have a more responsive business entity with the local presence. A mechanism with such glowing early returns we believe should be permitted to continue.

John.

Mr. SWEENEY. If I could just add a few items, one of the questions that has been raised as these sales have taken place is whether or not there is any danger of a violation of the antitrust statutes. We think that the manner in which the negotiations are conducted between buyer and seller and the arm's length method by which rates are then structured preclude antitrust considerations, and indeed, we believe that in many cases the entire competitive balance is well preserved, particularly as it relates to competition between rail and truck.

In so many instances where abandonments have occurred, the shipping communities in these areas have been left almost exclusively to truck transportation. Creation of shortlines provide an alternative and in many cases preserves the opportunities for shippers to obtain the best possible prices for the movement of their goods.

As to the issue of these transactions being substitutes for abandonment, we think that the process which must be undertaken protects against that. Typically, private capital is the heart and soul of these shortline acquisitions, and though there are risks of failure, the commitment that does take place indicates that there is a strong likelihood of financial return.

In our experience, the sales we have made are generally for more than the net liquidation value or our own indifference value, indicating the financial rewards from continued operation with local ownership far exceed current returns or realizable asset value and the economic rents otherwise potentially available to the seller.

Thus, while there is no complete assurance that the sales will avoid ultimate failure or abandonment, it is clear that this method of divestiture is based on the best formula to add value to the lines.

One of the responsibilities that I have within CSX is labor relations, and I think the question has been raised repeatedly as these items are discussed, are they really back door union busting? We do not really believe that. We see many of these shortline operations covered by union agreements, and particularly the larger line segments.

There has been generally favorable response by workers transferring from the seller to the short line because of the perception that with the smaller operations, each person makes more of an impact on the success or failure of the short line, In a number of instances that we know of, profit sharing has become an integral part of the shortline operations. We hope in the future to make certain that a number of the transactions we will undertake will be reinforced with profit sharing period, I might add, that profit sharing is a system that we hope to go to within our own corporation with our own work force.

The vast majority of the selling carriers' employees and their union agreements are unaffected. The sale decision is not directed at employees, rather, it is directed at assets which are not realizing satisfactory returns for a variety of reasons.

And that concludes the CSX presentation. We have, of course, submitted our full testimony for the record.

[The statement follows:]

STATEMENT OF JOHN L. SWEENEY, SENIOR VICE PRESIDENT, CORPORATE SERVICES AND PAUL R. GOODWIN, SENIOR VICE PRESIDENT, FINANCE AND PLANNING, CSX RAIL TRANSPORT

We are pleased to deliver our views on one of the most important developments in recent rail history: the expansion of short line or regional rail systems. For years, the only alternatives to uneconomic rail operations open to states, communities, shippers, and railroads has been continued losses with cross subsidization from other operations or abandonment. Now, in the last several years, all of the parties mentioned above have a new format for a continuation of rail service: the transfer of rail assets and, in most cases, rail personnel, to a newly formed railroad.

We in that segment of railroading most often described as Class I are enthusiastic about and supportive of this new format. It clearly enables us to concentrate more and more of our traffic on our major arteries with the improved economies of scale resulting from such concentration. In most cases, we have found that we have retained a significant volume of traffic on our major arteries, traffic that once moved on our secondary lines but now moving on property owned and operated by these new entrepreneurs.

In many cases, we can measure increased traffic as a result of the grassroots relationships that are established between the new operator and the shippers or receivers in these given areas.

In our company, we have made significant strides in decentralizing decision making so that our regional managers have sufficient autonomy to meet the particular needs of the regions. We do this in order to achieve more efficient operation but we cannot hope to replicate the hands-on capability that is produced by a regionally owned and operated railroad. Finally, it has been our observation that the overwhelming majority of these roads have found the means to achieve productivity gains that are beneficial to both of us when we seek to market transportation services to those who send or receive goods on both of our systems.

Mr. Chairman, there were a number of questions raised in the correspondence leading up to your hearing. We would devote the rest of our remarks to a summarization of our views on the issues raised.

We are never quite certain what the precise economic ingredients are of a successful divestiture as we have studied those that have occurred throughout the country. We have been able to determine the large volumes of traffic are not necessarily essential to a successful operation. As is the case with our own business, if one can operate efficiently at costs that meet or better those of the competition from other railroads or trucks, payrolls can be met, debts can be serviced and profits can be obtained.

We are largely under the impression that most new operators with whom we have dealt, and those in other railroad divestitures, can generally finance these operations through the private sector. There are, in some cases, operations which may be based on objectives other than pure rail service. These operations are generally conceived and implemented by public entities. As an industry, we have maintained that rail service that is premised on other than marketplace requirements, such as passenger carriage, should be financed through public sources. We make no judgement about the validity of these other public services but would certainly agree that where they exist, the money to achieve these purposes should come from public finance. We also believe this applies to capital equipment requirements; the private sector can finance those that will produce an economic return. The public should back those that serve social needs.

We have assumed that the sales of our properties—past, present, and future—are dependent on increased productivity. We have also assumed that buyers have worked out their relationship with their workers in a manner best designed to realize that productivity. In many cases they have negotiated with a union or several unions to produce those arrangements; in other cases, there is no union involved. It would be difficult for us to comment on those because we have never involved ourselves in such matters other than to provide our buyers with all of the revenue and costs data associated with our operation of the line in question.

We have provided information, upon request, as to the nature of our agreements with our unions. We have, on occasion, introduced the new operator to union leadership. Finally, in those states where public entities have taken an active role, we have joined in discussions with the buyers, public officials, and the unions interested in the disposition of those lines. We have no ability to forecast the degree of importance that improved labor agreements represent in the buyers ultimate decision to purchase the line.

On the question of federal involvement, we would offer the following observations. To the extent that the DOT is involved in broad policy issues and specific safety concerns, it should be no more or less involved with the new operators than it is with the existing carriers. We cannot comment on the need for continued efforts within the Local Rail Service Assistance Program other than what we have stated above. We have no suggestions as to additional ICC authority since we believe that the present supervision exercised is sufficient. We have already discussed the role of federal finance and will not comment further. We do not believe there is any need to change any labor statues or regulations. We have always been mindful of the need, in our negotiations with prospective buyers to avoid any violations of the antitrust laws. I think we have done this successfully. We do not see these transactions as being more prone than any others we have undertaken, to disrupt existing competitive balances and we have no recommendations to make on proposal changes.

As to the issue of these transactions being substitutes for abandonments, we believe that the process which must be undertaken protects against the likelihood of failure. Typically, the private sector will provide capital for short line acquisitions. Although there are risks of failure, the commitment of private capital indicates that there is a strong likelihood of financial return. These sales are generally for more than net liquidation value or the selling carrier's indifference value indicating the financial rewards from continued operation with localized ownership far exceed current returns or realizable asset values and those economic rents otherwise potentially obtainable by the seller. Thus, while there is no compete assurance that the sales will avoid ultimate failure or abandonment, it is clear that this method of divestiture is based on the best formula to add value and avoid liquidation.

On the question of these acquisitions representing backdoor union busting, we do not concur. Many shortline operations are covered by union agreements, particularly the larger line segments. There has been generally favorable response by workers transferring from the seller to the short line, because of the perception that with the smaller operation each person makes more of an impact on success (often reinforced with profit sharing). The vast majority of the selling carrier's employees and their union agreements are unaffected. The sale decision is not directed at employees, rather it is directed at assets which are not realizing satisfactory returns for a variety of reasons.

Regarding continuing marketing assistance and cooperation on rates, we believe that it is in the seller's interest to help to insure the traffic continues to be handled by rail, and that the joint route involving seller and buyer continues to be most attractive to the customer. The seller will typically maintain all connections and will work to provide marketing assistance. Rate relationships take many forms and are generally determined at time of sale. Mutual interest, again, tends to foster cooperation on new rates to maximize volume via the rail mode.

As to the shippers responsibilities, they consist of whatever they feel must be undertaken, based on their own self interest, no more, no less. The shippers responsibilities center around using the line if it provides the best transportation alternative. It is our experience short line operators offer a superior alternative than the pre-transaction operation.

We believe there is no problem whatsoever as to managerial talent. Managerial and enterpreneurial talent will respond to opportunities as they arise. This phenomenon has manifest itself repeatedly throughout railroad history and most certainly in the recent past with the burgeoning short line/feeder line rail industry. Experience tells us that, indeed, there is no shortage of qualified, financially backed, managers and operators. Word merely needs to be gotten out that opportunities are available and the enterpreneurial response will be forthcoming.

We really do not feel qualified to comment on the Soo Line model. We have not given it sufficient study to tell whether or not it would serve the purpose of our railroad. These are clearly many questions that need to be answered and we assume these will be thoroughly aired if the Soo proceeds to implement its proposals.

As to the involvement of EDA or SBA, we believe that, to the extent short line/feeder line operations qualify, they should have the same opportunities afforded other like businesses in other industries, to apply for EDA or SBA assistance. Such agencies should have no greater (or lesser) participation in a rail line divestiture than they would have in any other enterprise where the agencies have determined their involvement is warranted. The divestiture should receive neither favored nor discriminatory treatment from these agencies; the divestitute should stand (or fall), vis-a-vis competitive projects, on its own merits.

Regarding the questions raised on agricultural requirements, we assume any supplemental aid would not involve economically viable rail lines, which lines tend to take care of themselves. Therefore, the issue becomes one of social and public policy and would involve divestitures by abandonment not divestiture by sale for continued operations. If the federal government ultimately determines that light density, uneconomical rail service should be continued to satisfy rural and farm requirements, and pure economics argues against retention, then a subsidy or credits should be forthcoming.

Finally, you have asked whether the committee should consider other actions that might be taken to encourage the formation of such new railroads. It might be very useful to discuss with you the many ways in which the federal government might assist in these activities. But we, as an industry, and as a company, have tended to oppose financial subsidies to any segment of the transportation industry. You have all been aware of our position on the programs of the Army Corps of Engineers and also on federal and state highway programs where we believe subsidies do exist to our competition on the inland waterways and highways. We have constantly urged not that we be given equal subsidies but that these existing subsidies be gradually terminated. It would be with considerable ill grace were we now to purpose subsidies that would enable an expansion of newly formed rail companies. In short, as it relates to any proposed revision of government practices, we would fall back on the well worn expression, "if it an't broke, don't fix it."

Senator PRESSLER. Is Mr. O.M. Berge here, the chairman of the Railway Labor Executives?

Mr. BERGE. We understood we were to be kept separate from these and come on last. That is what I was told.

Senator PRESSLER. That is fine with me.

First of all, I want to thank you very much. I want to say that I recently saw Mr. Snow, who I think works with you, and please give him my best.

I have expressed concern over the deferred maintenance issue. If you as class I railroads are going to make the divestiture option work, it seems to me that you have a responsibility to make certain these lines do not deteriorate beyond the point of no return.

How can we ensure that this happens without excess Government regulation?

I will throw that out to any of you.

Mr. GOODWIN. Well, Mr. Chairman, I will give that one a try.

It seems to me that the deferred maintenance question is one which derives from economic decisions that the railroad companies make. Some reference has been made to deferred maintenance on certain B&O lines, and we would point out that an extraordinary amount of money was invested in the B&O by the C&O over a number of years and brought that property up to substantially a better state of maintenance.

When you get into branch lines there is an economic threshold where continued investment is either profitable or unprofitable, and to the extent that the rail carriers can enjoy economic benefits, they will make those investments. To the extent that other entities, possibly regional railroads or supplemental carriers, can make those investments, they will do so, and it will be in the line and the community's interests to operate those railroads with an economic structure which encourages that investment.

In the absence of return, private industry generally will seek alternatives to disinvestment, but if those are not forthcoming, lack of investment or disinvestment is normally the consequence.

Senator PRESSLER. Yes, that I understand. But what happens is that the railroad decides, perhaps forced by economics, to let a railroad deteriorate to a point of no return, or you have got a 5-mile-an-hour train on it that is derailing once a week. Of course, then the arguments for abandonment become almost a self-fulfilling prophesy. I do not like to see any more re-regulation or complete repeal of Staggers, necessarily, but how do we address this problem in Government where it is apparent that a large carrier is just letting a line go?

Mr. **Goodwin**. Well, I think steps have been taken with the deregulation efforts, and I do believe that the private sector, as evidenced by the vast increase in interest in regional carriers, will provide the capital, that capital will be forthcoming in areas that it can be productive.

So I think that very substantial steps in the deregulation arena have been taken, and they are working exactly as you suggest, Mr. Chairman.

Mr. **Reardon**. I might add to that, Mr. Chairman, if I might, and that is that the more attractive the disposition program is, that is, the less onerous conditions are imposed, then the more incentive a trunk carrier has to dispose of that track while it is still in a positive condition; whereas if it believes that abandonment is the only alternative, then frankly, there is less incentive involved.

Senator **Pressler**. Another question that I have goes to the heart of the matter of rules and so forth.

Some of the small short line railroads and regional railroads are fearful that as time passes and in certain conditions they will not have bargaining power sufficient to protect themselves and to get hook-up agreements or rates or whatever it is, whatever the controversy might be with the big railroads, and that there might be a need for regulation to protect the short lines.

How do you see this?

Mr. **Reardon**. I would like to respond to that, and that is that I think that the parties themselves can resort to self-help without the necessity of Government regulation. Specifically, when these transactions are entered into, and I can think of one in particular, a major transaction involving ICG, in which we contractually agreed not to close gateways, and also entered into a rates and divisions agreement with the regional carrier so that they have a private means of self-protection.

Mr. **Sweeney**. And I would like to add to that, Senator, that the reverse question is almost always the one that bothers most railroads when it is entering into a sales transaction, and that is the degree to which the new railroad will have opportunities to divert traffic to other major carriers. A number of the lines that we are contemplating and are engaged, indeed, in negotiations on sales are those which have outlets to both the Norfolk Southern and ConRail.

So our problem is not normally the question are we going to be able to coerce unfavorable rates. Our problem is are we going to be able to maintain any of the traffic that has formerly moved on those lines.

Senator **Pressler**. As time passes, I think it is well for the large railroads to note that one way to head off Federal regulation, hated Federal regulation, is to be generous in these agreements, which I think you have been in many cases. These short lines will be coming to Senator Rockefeller, myself, and others for help, and we would just as soon not legislate. But the small railroads do not have the comparative power, and it takes two to negotiate.

So you are at a comparative advantage in terms of sheer negotiating strength. Do not take undue advantage of that.

Senator Rockefeller.

Senator **Rockefeller**. Thank you, Mr. Chairman.

First I want to welcome Mr. Sweeney. I have known Mr. Sweeney for 20 years.

Mr. **Sweeney**. Twenty years.

Senator **Rockefeller**. And throughout the years we have agreed on approximtely 100 percent of the issues that we have discussed. That may not be totally the case today, but I very much respect you, as you know, and I think you have rendered great service to this country in a variety of ways.

It is my understanding that both of you are not entirely familiar with the railroad bridge situation in Charleston.

Mr. **Sweeney**. I am wagging my head as fast as I can.

Senator **Rockefeller**. I hope you will become so, though, because it is urgent for that capital city. Union Carbide and Monsanto and FMC are quite serious about their very deep concern on this, and quite frankly, I am not so sure why it would be all that expensive for the Chessie System to fix the railroad, to repair the railroad, and in fact, I might inquire for the record how much the Chessie System estimates it would cost to repair the railroad, No. 1; and No. 2, what part of your total budget for repairs throughout your system that cost might represent.

It just seems to me that when you have such major corporations in a State where you do so very, very much business, and where so very many people are employed not only directly by you but because of you, that that particular investment is very important to you as well as to the State of West Virginia, and I would ask, Mr. Sweeney, that you could make that information available to me as a Senator from West Virginia, as well as to the committee, if you would.

Mr. **Sweeney**. Senator, we did hear your colloquy with Chairman Gradison, and we will certainly cooperate in that undertaking that she is going to initiate on your behalf. We will do more than that. We will be in privately to see you, provide the information for the committee, because you really have got in front of you two fellows who really I do not think at this moment can really talk—we tried to reach some people who would perhaps allow us to be more responsive. They unfortunately are just out of pocket at the moment. And we will get to them immediately upon leaving here, we will get the data, we will bring it in, and then we will sit down and talk both with you and at that public meeting that will take place in Charleston.

Senator **Rockefeller**. Good, good. Thank you, Mr. Sweeney.

Further, CSX has announced plans to reorganize. CSX is reorganizing, and in fact, there is a real possible reduction of about 1,000 miles of track in that reorganization.

Now, to be more specific about it, I am under the very strong impression that the Chessie System has for a period of about a year been in a conscious move to set the B&O main line that goes from Parkersburg to Clarksburg, to set that up for abandonment, and that this is not necessarily announced, but nevertheless, a plan that Chessie has for its future, the abandonment of that whole Parkersburg-to-Clarksburg line.

Can you confirm that?

Mr. **SWEENEY**. Yes, sir. I think we have stated in a number of public meetings in the area, particularly that served by Congressman Mollohan, that since there is absolutely no local traffic on that line, it has been an overhead route for us, that the traffic has indeed been rerouted, and that at an appropriate stage—we will ask the Commission for the authority to abandon it. And we have made that clear—I do not think we have tried to dissemble on that subject.

Senator **ROCKEFELLER**. On that, there are a number of small coal operators that are on that line in a part of the State where the sulfur content of coal tends to be higher and therefore market problems ever more difficult. What we want to try to avoid, if this is what you are going to attempt to do, is a situation wherein the line is allowed to deteriorate, and we want to encourage a chance for takeover by a short line operator.

Will you be willing to cooperate in that effort or, in fact, are you trying to be helpful with respect to a short line takeover for that trackage if the abandonment should be successful?

Mr. **SWEENEY**. I guess I am a little confused as to the precise stretch that we would abandon. I do not think we even have coal shippers on it. There are no shippers at all on the stretch we would plan to abandon, roughly 60 miles. There is to the east, there are a substantial number of shippers who, by the way, whose ability to get in and out would not be affected by this transaction. There are alternative routes because most of those markets, most of the market for that coal is eastern export.

We have had conversations with Conrail which are inconclusive about their interest in it, and we certainly will be entertaining discussions with short line operators.

Senator **ROCKEFELLER**. How do you do that? In other words, a bad example was deferred maintenance with the South Branch Railroad, where over a period of 30 years nothing really happened and trackage on which there was a derailment a week and a 5-mile-per-hour speed—we want to avoid that.

How do you help in working with short lines?

Mr. **SWEENEY**. I will let Mr. Goodwin.

Mr. **GOODWIN**. I think we can state, really as a matter of policy, we always prefer the short line solution to an abandonment solution, and we have a large number of contacts, a large stable, if you will, of people who are interested in short line operations, and whenever we have a candidate for rationalization in some form, we seek to determine, we do some internal analysis and hold discussions with these individuals to see whether service can be preserved because it is really in our mutual interest to do so. We both benefit from such a partnership.

So as a matter of policy we do that. We have the contacts, and we enter into those discussions before we pursue the least preferable course of abandonment.

Mr. **SWEENEY**. And we would, for example, start with somebody like Bobbie up there who would be the person most tied in to all of those loops, to get her thoughts on what she thinks would be the right kind of proposal to work out an agreement with future short line operations.

Senator **Rockefeller**. Mr. Chairman, I know my time is up, but I want to ask just one more question, a little philosophical in nature.

CSX is not a poor company, and I understand in a business sense that capital flows to places where capital can grow. But you know West Virginia, Mr. Sweeney, very well. You know the particular nature of its economic distress, the particular nature of its topography, the particular importance of railroads.

With that as a setting, how do you describe rationalizing, the word "rationalizing," or that process wherein a decision is made that a certain area is simply not sufficiently beneficial economically for CSX to continue operations, as opposed to a decision that the line is not as beneficial as it might be, but it is clearly important to that area, it has some merit to us as a corporation, and therefore we should continue. It cannot be defended as the best economic decision, but it can be defended as an adequate, defendable economic decision.

How do you draw the line on that?

Mr. **Sweeney**. I am going to ask Mr. Goodwin to follow up, but I think the overwhelming concern any corporation has is can it compete in the capital markets because if you cannot through either equity issues or debt get the capital you need to continue to revitalize and expand and improve your physical plant as well as your equipment, you eventually end up in a chapter 11 situation. And we have seen that happen repeatedly with the industry.

I think there are now 11 really viable class I carriers in the United States, when only a couple short decades ago there were over 60. There are obviously external factors that have brought some of that about, not the least of which is the competitive advantages enjoyed by our major competitors, the truckers. You know, that some 20 years ago we carried roughly about 70 percent of all the intercity traffic. We now carry in the 30 percent range.

But you have to be able to get that money from Wall Street in some way, and therefore you set yourself a goal of return on that capital that makes it attractive for those investors to provide you with the funds you do need.

Now, for the process by which you then decide individual investments, I am going to give that easy task to Mr. Goodwin.

Mr. **Sweeney**. Because it is not easy. It is terribly hard.

Mr. **Goodwin**. Well, the economic process, as we all know, is to look at the return on any investment to justify it, but more specifically, Senator, to your question, where we do have investment candidates, on lines which are not providing that return, we do attempt to find a middle ground. If there are other interested parties who have a different set of economics, if there are public bodies or regions which have different interests, we attempt to work with those to see if there is not a mutually acceptable solution.

The donation that you mentioned is not completely unique. We are preparing to make a similar donation in the State of Maryland. We have worked out a purchase arrangement with some interests in southern Ohio. So when attempting to accommodate a region's problems we consider more than just the pure economic return to CSX, and we attempt to accommodate the interested parties.

But it is done on a case-by-case basis as these issues come up. If we can find a solution which is handled in the private sector through mutual economic benefit such as the short lines, we will take that route. That usually leaves everyone happy. If other arrangements or negotiations are needed, we certainly will attempt to exhaust those before we take the abandonment route.

Senator **ROCKEFELLER**. Thank you, Mr. Chairman.

Senator **PRESSLER**. Thank you.

I thank the panel very much.

At this time we will call forward Mr. O.M. Berge, chairman, Railway Labor Executives' Association, Washington, DC.

We welcome you. You may proceed. We will put your entire statement in the record as is the practice, and if you can give us the highlights, we would much appreciate it.

STATEMENT OF O.M. BERGE, CHAIRMAN, RAILWAY LABOR EXECUTIVES' ASSOCIATION, ACCOMPANIED BY G.W. MAHONEY, COUNSEL

Mr. **BERGE**. Thank you.

My name is Ole Berge. I am chairman of the Railway Labor Executives' Association and president of the Brotherhood of Maintenance of Way Employees. With me today is Mr. Mahoney who is counsel for the Railway Labor Executives' Association.

Rail Labor appreciates this opportunity to present its views on a matter that is quite literally vital to the interests of the employees of this Nation's railroads and to the public interest.

In November 1985 the RLEA submitted testimony to this subcommittee on the effects upon employees of the ICC's interpretation of the Staggers Act. I ask that that testimony also be considered at this time. It focuses upon the history of employee protection prior to the enactment of the Staggers Act and subsequent thereto. It details the historical concern of Congress for the welfare of railroad employees from the Discretionary Arbitration Act of 1888 through the Emergency Railroad Transportation Act of 1933, and the Staggers Rail Act of 1980.

In a relatively few years, our industries and even our society generally has evidenced a rather pronounced change in direction. Our industries, particularly our transportation industries, have shifted from competition based on quality of service to competition based on price, and this has resulted in cost cutting as the major contributor to profits, with employees' wages and benefits as the first target.

Companies and company managers seek to become rich at the expense of their employees. During the recent AT&T strike, it was reported that the president of that company had just received an annual pay increase of 33 percent to $1.32 million a year, while offering his employees a 1.6-percent and then a 2.3-annual increase.

Senator **PRESSLER**. Say that again. How much was the executive's increase?

Mr. **BERGE**. He was granted, the president of the company was granted an annual pay increase of 33 percent, which increased his annual salary to $1.32 million a year. At the same time, the employees were offered an annual increase of 1.6 percent, and then a 2.3-annual increase.

Over the course of time, many things change. Economic conditions vary, societal conditions vary, and even the shape of our continent changes. But one thing remains constant, human nature. It was the unbridled exercise of one aspect of that nature, greed, by the industrial barons of the last century that forced governmental controls upon business and industry in the latter part of that century and the early 20th century. The railroad industry was one of the first to have controls placed upon it. Many of those controls have now been removed through the enactment of the Staggers Act, and so, reflecting the times, the railroads would rid themselves of branch lines, aided by the Interstate Commerce Commission, and strip their systems to a few high-density lines operated by a few railroad companies with very few employees.

The railroads do this, they say, in order to enable them to compete with an unregulated motor carrier industry. The shortlines they create at the primary expense of their employees are, they claim, more efficient and more productive because the shortlines can employ fewer people to do more work with less pay.

What is the ultimate goal in productivity and efficiency in our industry today? A 12-hour day, a 7-day week, a 52-week year, all at minimum wages? Is that really what we want in this country? Do we want today what we had 100 years ago, a nation of masters, servants with the working people stripped of human dignity?

I do not want to believe that.

The Staggers Act was passed with the support of rail labor because employees were to be protected, to provide railroads with an opportunity to compete in the marketplace, and it did that. However, it has also done something else. As it has been interpreted and applied by the ICC, it has allowed the railroads not only to rid themselves of unprofitable lines, but to abandon profitable lines as well as it is being used blatantly as a union busting weapon.

These castoff lines are the lines that have become and are becoming our shortline network. Unlike air and motor carrier industries, the railroad industry comprises of an enormous fixed plant. It is inflexible, and when it is gone, it will be gone forever. The so-called independent shortlines can easily be abandoned at the first glint of financial difficulty and without employee protection.

The railroads are now extending their use of the antiunion bias of the ICC by converting some of their own lines into cutrate subsidiaries, as the Soo Line is planning to do, or as in the case of the Chicago & Northwestern, have someone create an independent, paper railroad to buy 1,000 miles of line, staff it with Chicago & Northwestern officials who retire or resign from the Chicago & Northwestern, and have the new officials of that paper company, which has yet no property or operations or revenue, negotiate directly with the employees of the Chicago & Northwestern on the lines to be sold, for substandard rates of pay and benefits while informing them that it will be a nonunion railroad, and it will contract out all of the rehabilitation work which should be performed by employees of my union.

This railroad, known as the Dakota, Minnesota & Eastern, which as I said, is not yet operative, was listed on page 39 of the June 1986 issue of the Railway Age as being the top of the top 20 new or expanded railroads, with 980 miles of line and an estimated annual revenue of $50 million.

My own recent experience during and after my brotherhood's strike against the Maine Central and Portland Terminal Railroad tells me that those railroads and probably other Guilford lines will seek to lease or sell many of their lines to real or paper companies as a means of abolishing jobs without employee protection and cutting union membership.

None of these antiunion activities could take place without the full cooperation of the ICC. And there appears to be a possible recognition of what the Commission is doing from at least one member of the Commission itself in dissents in two recent cases which I received in last Monday's mail. I would like to submit them for the record.

Another Commissioner also dissented in one of those cases. His dissent appears at page 8 through 10 of the *Arkansas & Missouri Railroad* decision I have submitted. While perhaps well intentioned, this Commissioner's suggestion, if put into practice, would strip the employees of virtually all Railway Labor Act rights, all compensatory protection, force them into interest arbitration, contrary to the consistent practice in this industry since 1888, and would be unworkable since it would only apply to one of the two railroad parties to the transaction.

We believe the Congress must take a very hard look at what is happening in this country to the railroad industry, its employees and their Railway Labor Act rights under the ICC-interpreted Staggers Act. We have to decide whether we want a few high density main lines owned by fewer and fewer railroads and a system of hundreds of short feeder lines which could be gone from the transportation scene in an instant. We must determine whether higher and higher profits for corporations is the main, if indeed not the only purpose for the existence of railroads in this country.

The shortline network has been created at the direct expense of the employees of the railroads of this nation. Before the ICC switched direction in its view of the rights of railroad employees, their interests had been protected. When a railroad made a profit or cut its losses by abandonment and sale of a line, the employees and their families who paid for those profits or savings with their very livelihoods were allowed to share in those profits or savings.

Not so today thanks to the Commission's application of what it perceives to be a congressional intention to deprive employees of protection. The shortline now contend that they cannot withstand the cost of employee protection, but the railroads are the first to tell you that they are financially much better off today than they were in the past, primarily due to the rate freedom and exemptions provided by the Staggers Act. Yet, it was in those financial dismal, pre-Staggers days that the Commission imposed employee protection, and it did so without complaints from the railroads.

This intolerable, unjust situation must be ended. It is clear that the ICC and its instigators will not end it. Only the Congress can do so, and we respecfully but strenuously urge that it do so immediately by the enactment of the amendments which are attached to my prepared testimony as Exhibit No. 12.

Thank you, Mr. Chairman.

Senator PRESSLER. Thank you very much.

First of all, is it true that FELA applies a unique standard of liability to railroads, and if so, what is the justification for retaining it today? It has been argued that FELA, an 80-year-old law which was enacted prior to workers' compensation laws, is outdated and exposes the employer to full tort damages while imposing almost strict liability standards.

Is FELA still justified today, and why or why not?

Mr. BERGE. In my view, FELA is justified today just as much as it was in the first place, and the existence of FELA became necessary because of the way the railroads treated their employees. The Congress recognized that the railroad industry, being a very dangerous industry to work in, needed protection, and that is why we have FELA. It has worked well.

The railroads would not have to fear FELA to the extent that they appear to if they would provide a safe workplace for their employees. After all, the employees have to show some responsibility on the employer before they get a dime out of FELA.

So there is no reason in my view that FELA should be changed in any way.

Senator PRESSLER. Now, why would workmen's compensation not work as they do in other industries?

Mr. BERGE. Well, having spent my entire lifetime in the railroad industry, I have to confess that I am not conversant with the State workmen's compensation plans, but I do not think it would provide the protection that employees in this very dangerous industry to work in, I do not believe they provide the protection for a loss of two legs, for example, of someone that is perhaps 28 years old, has two small children and a wife to support for the rest of his life.

But I am really not in a position to compare the two because I do not know anything about workmen's compensation laws.

Senator PRESSLER. Well, I would much appreciate if you would submit that for the record. Of course, you may have your legal department prepare it. I am trying to study this. I am not advocating anything here, but am interested in an explanation of why the workmen's compensation standards which are used in other industries would not be adequate here, and why workers comp laws would not work for the railroad industry. I would appreciate it very much, Ole. I can understand you would not be prepared, but that is something that I am trying to genuinely understand, and I would like your point of view on it.

Mr. BERGE. We will be glad to prepare such a document for you.

Senator PRESSLER. Another area I am interested in—and by the way, on a philosophical note, I share your concern about our Government and executives and labor. I have frequently said that I think some of the golden parachute agreements on the part of management and some of the salaries are, in my view, exorbitant. I have said that about some labor agreements, and I have said it about some Government practices. I think if we are going to compete with Japan and other countries, we are going to have to be more efficient all the way across the board. And there are abuses in each area.

That is just philosophically something I am throwing out.

But do you agree that the economics are such that short lines require more flexible work rules than do larger railroads, and do you think bonus and profit sharing programs are a good tradeoff for flexible work rules?

Mr. **Berge**. I am going to defer to our counsel who, as counsel for the RLEA now for some 30 years, is recognized as an individual that knows more about employee protection and these matters than anyone else in the industry.

Mr. **Mahoney**. Mr. Chairman, one must view this from the point of view of the employee who is working, say, for the C&NW on the line that this DM&E will purchase. He has been working for that railroad for maybe 25 years. He is suddenly told that it is going to be abandoned, abandoned. He knows that if it is abandoned he will receive protection from the Interstate Commerce Commission.

He then is told, no, it is not going to be abandoned, it is going to be sold to another railroad. He now knows he will receive no protection. He is then told that he must resign from the C&NW if he wants to apply for employment with this new railroad.

Now, there is no guarantee that the new railroad will hire him, but he has to resign from the C&NW if he wants to apply for employment with that railroad. He is also told that he will have no more union representation when this new railroad takes over. He is also told that his wages will be lower. He is also told that he will do different types of work than he did before, or whatever the company gives him.

So if he is protected, if there was Commission imposition of protection in these cases, the cost of the protection would not be placed upon the DM&E, and that is something that I could not understand from either Chairman Gradison or Mr. Riley, they must know that the ICC has never imposed protection on the vendee, the buyer, and we have never asked that they impose protection on the vendee. It is on the vendor, the giant railroad that is ridding itself of a line to make profit.

And it will make profit, probably, as they have said here today, because they are not going to have to scrap the railroad and pay 6 years protection. They are going to sell a railroad that is going to continue to supply them with shipments so that they will make money from this railroad. And at the same time, they are not going to have to do anything for their employees. And it is an easy way to get rid of their employees.

And we believe and we perceive it to be a means that they are using to do just that. No one, the Commission nor any of the railroads that I know of has ever told the Commission or attempted to tell the Commission nor has the Commission ever attempted to make a finding as to just what the cost of the protection would be in any given case, any case at all, and we would be glad to attempt to do that for this committee by creating an economic model of what one would cost in these circumstances.

But the Commission has never, ever made an attempt to make such a finding. As a matter of fact, it has been reversed by a court of appeals which said that what they are doing now is union busting, and the ICC's lawyer agreed with that unanimous court that it was union busting because of the method that they followed in reaching their conclusions.

So I, as I say, cannot understand why they say that this would stop any of these sales at all. It never did in the past, and there were sales in the past, and protection was always included. But you have to remember that for every man hired by the new railroad, that is one fewer person that the selling railroad would have to protect. And attrition takes its effect, and as people die and retire, these people have to bid into those jobs or they lose protection. And many years ago the RLEA did make a study, not in depth, and it certainly would not be material today because it was so old, but at that time it was figured that the actual cost to a railroad of this type of protection comes to 15 percent of the potential cost.

So these things are not as bad as they seem, nor would they be as catastrophic as they seem. They have done it before, the Commission has always done it. On page 9 and 10 of Mr. Berge's prepared statement, you will find a quotation from a Commission decision, the last one, I might add, before Staggers, in which the Commission did impose protection on the selling carrier, the Denver & Rio Grande.

Senator PRESSLER. Well, I am not in a labor-management dispute here. But one of the examples that has been cited to me as very difficult and very expensive is the 6 year protection with full pay.

Do other industries get that? Is that something we can justify today. Maybe I am misinformed, but is that the kind of protection that you would seek with the shortline railroads?

Mr. MAHONEY. Well, again I say, we do not seek any protection from the shortline railroads, none at all. We seek it from the giants that are selling off their property to the shortlines and making money off of that. That is who we seek it from.

We seek nothing from the shortline except that the shortline, as the Commission found and held in the Durango & Silverton-D&RGW case, just before Staggers was passed, all the shortline has to do under that protection is negotiate with the union and with the selling railroad regarding the numbers of people to come over, and if the shortline says we only need 50 percent of the people you have been using, and the union says you ought to have more, and the selling carrier says you ought to have more in an attempt to cut its liability, they can go to arbitration and make a determination on that from arbitration.

But the buying carrier is not financially responsible for any of that protection.

Senator PRESSLER. Well, I understand that the protection is not from the shortlines but the giants. The giants tell me they pass the cost of protection on to the shortline in the purchase price, making the acquisition costs prohibitive for the shortline & regional railroads.

Mr. MAHONEY. That is an easy conclusion for them to reach and make that statement, but as I said a little earlier, they have never, ever said to either the Commission or to us or to anyone what that would cost in any given case. And we made a study a long time ago, which I am not saying would be material or even relevant today, that the cost is about 15 percent, the actual cost is about 15 percent of potential.

And we would be glad to give you an economic model, if we can put one together, of what one of these things would cost today.

Senator **Pressler**. I guess what we are faced with in my part of the world is some jobs or no jobs; some railroad transportation or no railroad transportation. I think that eventually the Chicago & North Western, for example, would have been abandoned. It would have been allowed to be abandoned. I could have gone downtown and beat on the doors again for a few more years, maybe, and held it off. But eventually the standards were there and the composition of the Commission was such that I think we would have probably lost. I am not sure of that, but we would have kept on trying.

So really we were faced with a choice between no railroad or a regional line. In terms of jobs in that area, you are faced with either jobs with the regional system or no jobs at all. And as the able witness from Huron testified, the going rates for skilled labor out there are from $6 to $10 an hour. I imagine those are a mixture of nonunion and union. It is my understanding that the new railroad will pay higher wages than that.

So what alternatives does a region face? What do you recommend? Do you recommend no jobs and no railroad. How do we work it out? What should we have done?

Mr. **Mahoney**. If the Interstate Commerce Commission had interpreted 10901 as it has interpreted that section prior to the enactment of the Staggers Act, we would be all for the short line situation because when you say all jobs or no jobs, what we are looking at is no jobs with protection or maybe 50 percent of the jobs with no protection. In other words, half the people would be hired, not all of them will be hired, and they will not get any—those who are not hired get nothing. And they are cast aside.

What we are saying is that these people should be protected.

Mr. Haley said, as I recall his testimony, that he would not, could not have gone through with his deal with the ICG if there had been employee protection, and in the very next breath Mr. Haley said he has more employees now than the ICG had out there and he is paying them better. Well, if that is the case, the protection would not have cost one cent, not a penny, and the deal should have gone through. Where was the cost?

People are only given money if they are affected monetarily under these protective arrangements. And then it would have been the ICG that would have had to pay it. In this case the ICG would have had to pay nothing, as Mr. Haley said.

So I do not know what the objection is except, except they can do what the C&NW is now doing to the people in your State. It is going out there and holding meetings with those people and telling them you have got no rights, you have got nothing, if you want to sign up with us you can, but you are going to have to resign from your present employer. And they do not know what is coming at them. They have got no rights the way the C&NW is looking at it.

And what the C&NW is doing, by using its employees or former employees, and which it is paying with its money, although they are getting, I guess, a DM&E paycheck, because I understand, I have been told over the telephone that the C&NW has lent the

DM&E $4 million as seed money to get started. So the C&NW is lending money to the DM&E to pay former C&NW officers to go out and bargain with employees individually. And if C&NW people tried to do that directly, they would be in violation of the Railway Labor Act.

But this is what these people, these employees are faced with. And I cannot believe that they are happy with this situation. And in fact, we have been told they are not.

Senator **Pressler**. That is not my understanding of what is happening, and I would like to meet with you and staff afterwards to discuss that, and also give C&NW a chance to submit a response to that.

Mr. **Mahoney**. I would be happy to, Senator, but we have sent a telegram to the C&NW asking them for information, asking them what they are going to do about this. We have sent, the unions have sent section 6 notices under the Railway Labor Act to negotiate with the C&NW as to how this line should be spun off and what will happen to the people. The C&NW, so far as I understand, have told us that it is none of our business, that is an invalid notice.

We are going into court to try to stop this thing until we have the rights of these people respected.

Senator **Pressler**. Well, then, I guess this whole discussion boils down to whether labor protection affects these deals or not, and you think it does not?

Mr. **Mahoney**. Not appreciably. It would affect them to some extent, perhaps, but not appreciably.

Senator **Pressler**. All right.

I may have some additional questions from Senator Rockefeller and myself, and I want to thank you very much for being here. We would like to have a meeting on that subject that you raised because I want to learn more about that.

Mr. **Mahoney**. Certainly.

Senator **Pressler**. I should say that I want to thank everyone who participated in these hearings. I want to thank Senator Packwood for allowing these hearings to be held, Senator Rockefeller for his great contributions not only here and on other occasions, my staff person Kevin Schieffer who does an excellent job for me, Bob Samors, Pamela Garvie, who put the hearing together, and Linda Morgan of the minority. There are a number of other things that led up to this hearing. We had a rail conference which Ray Chambers pulled together which was very useful, and Ray Chambers did an excellent job of laying the groundwork for this hearing and getting the industry and labor and other people together. So I thank him.

I believe I have covered everything. There are additional questions for the witnesses, and if there is no further business, I will conclude this hearing.

[Whereupon, at 12:51 p.m., the subcommittee recessed subject to the call of the Chair.]

ADDITIONAL ARTICLES, LETTERS, AND STATEMENTS

STATEMENT OF DAVID J. ASTLE, ASSISTANT COMMISSIONER, OREGON PUBLIC UTILITY COMMISSION

The Oregon Public Utility Commissioner, under Oregon Revised Statute 756.040, is empowered to "represent the customers of railroads, and the public generally in all controversies respecting rates, valuations, service and all other matters of which the commissioner has jurisdiction."

Relative to railroads, the Public Utility Commissioner: represents the state before the ICC; regulates the safety of rail equipment, including the use of cabooses; inspects tract, walkways and industrial sidings; administers the railroad highway crossing program; establishes standards for safe transportation by rail of hazardous materials and wastes; and approves the abandonment of railroad freight agencies.

The PUC and the Department of Transportation both play major roles in the preservation of direct rail service. Oregon legislation passed in both 1979 and in 1985, as well as the creation by Governor of a task force on rail line abandonment, have made clear the position of Oregon public officials that direct rail service is important to the economy of our state.

As abandonments have increased, the creation of short lines is being considered as a major strategy in preserving direct rail service. The formation of two such lines is explained in the testimony presented by Ed Immel, the Oregon Department of Transportation Rail Planner. Acting in concert with the Department of Transportation, the PUC plays three major roles in the formation of a new short line. They are as follows:

1. ABANDONMENT PROTESTS

The PUC is required by a state law, passed in 1985, to participate before the ICC in contested abandonments. Officials from other states have commented that such a requirement is burdensome. However, we have discovered that, though our protests before the Interstate Commerce Commission are often in vain, the effort in developing protests educates the shippers and the public, and provides both the OPUC and ODOT with the kind of information needed to determine the feasibility of a short line operation. It is an important discovery phase for all involved.

2. CREATION OF SHORT LINES

Should we not prevail in the abandonment phase, and if the Oregon Department of Transportation determines that a short line operation is economically feasible, ODOT takes the lead in providing assistance to the local community and the new railroad. The PUC, taking a secondary role to ODOT, provides technical assistance, as requested, on matters related to track and way, railroad operations and equipment, and crossing safety. This role carries over through the early months of a new short line operation.

3. RAILROAD REGULATION

Once a short line is established, the PUC, again, takes a major role as the authority responsible for rail safety and railroad-highway grade crossings. The PUC has traditionally used the routine track, equipment and employee safety inspections as a method of educating people on the safe operation of railroads. This has become more critical with the new short lines, since operators and owners may be railroad novices or may be new to running a railroad in Oregon.

We consider short lines, in some cases, to be a very good alternative to abandonment. The Governor's Task Force on Rail Line Abandonment, which is now finishing its job, agrees, though the task force also believes that hopeless lines should be abandoned and that Class I Carriers should be encouraged to continue operation of branch lines whenever possible.

Included in the testimony (Exhibit B) is a letter from task force member, Jeff Asay, who is an attorney with the Union Pacific Railroad. He clearly and accurately describes the advantages and disadvantages of operation by both Class I and a short line carrier.

We agree with Mr. Asay's analysis of the advantages and disadvantages; we are particularly concerned about certain problems that we believe may affect the future success of our short line operations.

1. LABOR

Successful short line operations offer two major advantages over Class I Carrier operation. One advantage is the entrepreneurial spirit of the new short lines. The other is lower labor costs. Any imposition of the work rules and wage rates typical on the big railroads would destory most small short line operations. That is not a supposition. It is a fact, which can easily be shown in the relatively simple equations used to determine the economic feasibility of a short line operation.

As an example, one private short line operation in Oregon, which purchased parts of lines threatened with abandonment, provides rail service to several mills. Without its service the mills would lose a very important mode of transportation. The entire operation is run by three people, all partners in the company. To feed their families they each moonlight. It is perhaps an extreme example, but given the traffic density of most Oregon branch lines, it is an accurate indicator of how important flexible work rules and salaries are to low density short lines.

2. RATE DIVISION AND LINE ACCESS

At present, our two newest short lines receive a division of the rate, set by contract. We consider these divisions fair and have found the connecting carrier to be more than cooperative. But, given problems that exist between some of our older short lines and their connecting carriers, we have a general concern about the long-term relationships between short lines and the connecting carriers.

A short line, in almost all cases, is a captive shipper. The connecting carrier has the potential of strangling a little short line. This can be done by refusing to give the short line a rate division and requiring the short line to publish its own tariffs, which almost always raises the total rate. It can also be done by giving the short line a rate division so low that the short line bankrupts. Finally, it can be done by the large carrier offering very good rates to a short line carrier's shippers to reload or piggyback on the main line.

Such behavier, and we know it exists, concerns us in general, but in particular when there is state and federal public investment in a line.

3. EQUIPMENT

Rolling stock availability and car hire provisions are particularly important to short line railroads. Again, they are often at the mercy of the connecting carrier. Reasonable car hire provisions can be handled by contract, and our experience is that the the connecting railroad is generally fair, but excessive rates would be a tool to eliminate a short line operation.

Car availability is not now a big problem, but given the trend in rail equipment we anticipate that shortages will develop in the kind of rolling stock used by small short line operations. Box cars are not being made at all; few, if any, refrigerator cars are being put on line; new hoppers and flat cars tend to be maximum size and often cannot be moved fully loaded on an aging feeder line.

4. INTERMODAL COMPETITION

The greatest, long term threat to short line railroads is intermodal competition from the connecting carrier and other carriers. We define intermodal as any of several truck-train combination movements, including piggyback, doublestack container trains, reload or transload operations and roadrailers. Railroads are aggressively marketing their intermodal services and solicit traffic off their own branch lines as well as off short lines and branch lines owned by other carriers.

In theory, we have no problem with that, providing the competition is fair. Indeed, such competition is healthy. We know, though, that railroads will subsidize an intermodal movement with the clear intention of destroying the direct rail competition and that, ultimately, when the direct rail service is gone, the shipper may end up with higher, non-competitive rates.

We also worry that the taxpayer may pay the price of cut-throat competition. We may lose whatever public investment is made in short lines and, additionally, we will pay the cost of the additional truck traffic on rural roads.

We believe that short lines can serve an important function in preserving rail service to many rural communities in Oregon. We also believe that limited financial assistance, particularly in the form of rehabilitation money, is a wise public investment. But we believe that short lines are more vulnerable than the larger carriers to competition from the big railroads and from the trucking industry. They are more vulnerable to natural disasters, since they generally don't have the financial depth of a Class I carrier. For the same reason, they are more vulnerable to the ups and downs in the economy.

How can the federal government help? We suggest the following:

1. Provide some form of protection to short line carriers against "cut-throat" practices, such as discounting reload or piggyback rates to shippers located on short lines and cancelling rate divisions.
2. Preserve the ability of short lines to operate with flexible work rules and lower pay scales. (Class I Carriers carrier should be encouraged to work toward the same.)
3. Maintain, or increase, the federal Rail Safety Grants-in-Aid Program, based on the fact that new short lines often take more time and attention from us to assure they are operating safely.
4. Maintain, or increase, the Local Rail Service Assistance funding to aid new short lines in making up for the Class I Carrier's deferred maintenance.

We are very encouraged by the new short lines and the new regional railroads and by the growing willingness of the big railroads to sell lines before they are worthless. We know, however, that our little lines have an uphill battle for survival, and our state's resources are far too limited to subsidize them, even if we thought that was a good idea.

We, meaning all of Oregon's state agencies, are doing what we can by educating the public on rail transportation. We are encouraging both state and local economic development entities to view rail as a resource and to make rail traffic enhancement a community goal. And, finally, we are helping communities make reasonable, realistic, unemotional decisions about their future transportation needs. Your assistance is important to us and we hope you will do what you can to give our newest railroads a fair chance.

THE AMERICAN SHORT LINE RAILROAD ASSOCIATION,
Washington, DC, August 7, 1986.

Hon. BOB PACKWOOD,
Chairman, Subcommittee on Surface Transportation, Committee on Commerce, Science and Transportation, U.S. Senate, Washington, DC.

DEAR MR. CHAIRMAN: These comments are submitted for the record of the hearing held by your Subcommittee July 25, 1986, on the "Establishment of New Short Line and Regional Railroads." The Association represents nearly 300 member railroads, including more than 100 new roads formed subsequent to enactment of The Staggers Rail Act in 1980.

The testimony presented by various witnesses at the hearing demonstrated only too clearly the reasons new small railroads have been able to step in and provide rail service for thousands upon thousands of shippers and communities throughout the nation when, but for them, these lines would have been abandoned and service would have terminated forever. There was also a consensus that this trend was likely to continue in the months and years ahead, though a number of issues were raised that could have a significant bearing on this process. We wish to stress our concern on these issues, as well.

One of the critical issues has to do with the Interstate Commerce Commission's policy of not imposing labor protection on sales of track to non-carriers. the continuance of this policy is essential to permit new operators to successfully operate rail lines that were not viable under prior ownership and would otherwise have been abandoned. While those attacking the policy state that the change they seek would impose the burden of labor protection only on the seller and it would have no effect on the purchaser, such a notion defies economic reality. It would be most unusual if a seller who incurred additional costs, whatever the reason be, on a particular transaction, did not attempt to recover all or part of them as part of the transaction. Furthermore, the witnesses who have participated in the start-up of new carriers indicated they would not have undertaken their venture had that occurred. If the Congress is truly concerned about the preservation of efficient rail service in many areas that will be confronted with abandonments in the year ahead, it should clearly not enact legislation to reverse the ICC's policy on labor protection.

Another issue enumerated was the cost burden on small carriers associated with the Federal Employers Liability Act. This was enacted in the early part of the 20th Century when railroading was an entirely different environment in which to work. While that environment has changed dramatically so that no one could reasonably believe that risks encountered by rail employees today are any greater, and indeed, may be less, than employees in other lines of work, the competitive environment faced by railroads has been even more radically changed. The railroad industry simply can no longer afford to pay the costs of a program designed for an industry that had a near monopoly on transportation, and this is particularly true of new carriers who must be extremely cost conscious. The premium for insurance to protect them from claims under FELA is exorbitant, yet the number of claims is small, as it should be in view of the overall safety record. It is high time to bring the rail industry up-to-date in terms of employee liability and provide a means of compensation for injuries that is similar to that in competitive modes. The replacement of FELA with coverage under state workers' compensation laws or the substantial reform of FELA are the only means to accomplish this goal.

Another issue raised was the importance of funds provided to small railroads under the Local Rail Assistance Act. This program has been targeted for extinction even since the Reagan Administration came into office following the 1980 election, but has managed to survive because a number of responsible elected officials have recognized the program for what it is: a sensible expenditure of minimal federal funds that provides a larger return to the taxpayer in terms of jobs and service than most other activities. This program has been responsible for the success of many small railroads that would not be in business today but for it. We applaud the bipatisan effort that has kept this program alive and encourage its supporters to continue their aggressive defense against its detractors.

Finally, the one ingredient without which few if any, of the myriad new railroads formed in recent years would have been created, or long survived for that matters, is "The Staggers Rail Act of 1980." Its enactment was the catalyst that encouraged investors to back entrepreneuers in fledgling new rail operations providing service where it otherwise would have been lost due to abandonment. This is no time to curtail the initiatives brought about by the Staggers Act and turn-the-clock back on the progress achieved under it.

We appreciate the opportunity to submit these views, and thank you and your Subcommittee for providing the forum for examining this topic.

Sincerely,

THOMAS C. DORSEY.

ASSOCIATION OF AMERICAN RAILROADS,
Washington, DC, August 11, 1986.

Hon. ROBERT PACKWOOD,
Chairman, Senate Subcommittee on Surface Transportation of the Committee on Commerce, Science, and Transportation, Senate Hart Office Building, Washington, DC.

DEAR CHAIRMAN PACKWOOD: On Friday, July 25, the Subcommittee held hearings to explore issues relating to shortline railroads. During the course of the hearings a number of matters affecting smaller railroads were raised and discussed by the witnesses and committee members. One of the most serious concerns expressed by the small railroads was the potentially devastating effects of the Federal Employer's Liability Act (FELA). I can assure you that concern with the FELA is not limited to small carriers and would like to take this opportunity to address the issue of the FELA from the perspective of the railroad industry as a whole.

The FELA is a federal law enacted in 1908 that provides a tort remedy for railroad employees who are injured on the job. At the time it was enacted no-fault compensation was a new and generally untried concept. In enacting the FELA, the Congress took the more familiar approach of basing employer liability for workplace injuries on the concept of fault, but modified some of the common law rules to make it easier for an injured employee to recover. A great deal has changed in the nearly eighty years since FELA's enactment, to the point where it has become an archaic law, ill-suited to serve its original purpose.

Today, the FELA is an inequitable and costly method of compensating employees for losses due to workplace injuries. In order to recover, an injured worker must prove that the railroad was at fault. If a settlement cannot be reached, this must be done at a trial which usually takes place several years after the accident occurred. Though the generous benefits available to railroad workers make it unlikely that the employee will be destitute during that period, it is absurd that it take so long for an injured worker to establish his right to recovery. In a minority of cases, due to the worker's contributory negligence or inability to prove fault, damages may be reduced or denied, leaving the worker with a debilitating injury and no right to compensation. Because of the inherent uncertainty and subjective nature of jury awards, even workers who establish their right to recovery may be recipients of vastly different sums despite suffering from similar injuries and disabilities.

Because it puts employers and employees in an adversarial situation, FELA has a detrimental effect on the workplace. The need to prove that the railroad was at fault in order to be compensated for injuries can create an antagonistic relationship between the employer and the employee. This can spill over to other employees who may have witnessed the accident and who therefore may be instrumental in establishing liability. In addition, the need to lay blame can divert attention from objective investigation of how to enhance workplace safety.

Though FELA is a fault-based system, the standard of liability has been so eroded over the years that it has become almost a foregone conclusion that the railroad will be found responsible for the injury.[1] What makes this most troublesome is that under FELA unlimited damages for both economic and non-economic losses are available. In essence FELA combines the guarantee of recovery of a no-fault system with unlimited damages of a tort system; from the employer's point of view, the worst of both worlds.

Another negative characteristic of the FELA is high transaction costs. The industry has found it to be a very expensive system to administer. In addition, a great deal of money must be paid to defense counsel. Finally, as is characteristic of personal injury litigation in general, a substantial amount of the money paid as an award goes not to the injured worker, but to his attorney. The high and unjustified costs that must be borne by the railroads because of FELA put the industry at a competitive disadvantage—the large railroads as well as the small.

For these reasons, summarily stated, the railroads believe being subject to FELA works a great unfairness on their industry—both to employees and to companies, though, to be sure, it provides windfalls to some employees and to many attorneys. This is the point that was made by several of the witnesses at the hearing. It was suggested on several occasions that, because it is unduly costly, FELA creates a particular hardship on small railroads, and, at least with respect to those railroads, ought to be replaced with a compensation sytem. While I concur with those views, I submit that they apply equally to the entire railroad industry.

At the turn of the century railroads were the dominant mode of transportation and their growth was essential to our nation's development. The railroad industry was the single largest non-farm employer in the United States, and railroad worker suffered high rates of injuries and fatalities. Under those circumstances—and given that, at the time, there were no established mechanisms for compensating injured employees—there was ample reason for enacting a law to protect railroad workers.

However, times have changed. The railroad industry is an established but no longer dominant mode of transportation. Job hazards are greatly diminished, and recent reports by the Office of Occupational Safety and Health Statistics of the Bureau of Labor Statistics show that rail transportation is one of the safest among heavy industries—being next to the lowest both in the incidence and severity of injuries. And in the last 5 years, the railroads' overall accident rate has steadily improved. Yet, while its overall accident rate improved, the incidence and severity of its injuries remained among the lowest of heavy industries, and its work force declined 30 percent, the railroad industry's payout under the FELA has increased by 53 percent in the last 5 years.

Today there is just no legitimate justification for keeping railroads and their workers subject to the FELA.

Workers who are hurt on the job deserve to be compensated for their injuries, and if FELA were the only option available toward achieving that end, the railroad industry would acknowledge its necessity. However, that is not the case. Today, nearly all other employees in this nation (with the only notable exception being seamen covered by the Jones Act) are covered by a no-fault compensation system—either in the form of a state worker's compensation law or a federal compensation statute (such as the Longshore and Harbor Workers Act). Worker's compensation laws cover employees in other industries (e.g., trucking) who, like railroad workers, may cross state lines in the course of their employment. These laws provide for swift and assured recovery at a guaranteed level of compensation.

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[1] In *Rogers* v. *Missouri Pacific Railroad*, 352 U.S. 500 (1957), the Supreme Court ruled that raising a jury question of negligence requires only evidence of the "slightest" negligence by the railroad. In *Gallick* v. *Baltimore & Ohio Railroad*, 372 U.S. 108 (1963), the Court held that a verdict for the plaintiff could stand on a finding that "[e]employer negligence had played any role in producing that harm."

The policy in this nation, followed with near unanimity, is that employees suffering workplace injuries should be compensated for their losses regardless of the cause of the accident or who was at fault. While I would not claim that every worker's compensation system in existence today is perfect, as a whole the no-fault compensation system has worked well in the context of workplace injuries. Given these circumstances, the burden of proof ought to be on those who urge retention of an outdated system that runs counter to what has been the prevailing thought for many decades. The onus should be on them to justify why one industry should continue to be treated differently from all the rest.

In recent years the FELA has not generated much discussion in Congress. Hopefully, these hearings will serve as a starting point for focusing attention on what is an extremely important issue for the railroad industry. The AAR will be happy to assist this committee, and others who are interested, in further exploring this issue and to supply additional materials and thoughts on the matter of the FELA, and why it should be repealed and replaced by a compensation system. Attached [2] to this letter is a copy of an article which appeared recently in the San Diego Law Review. It provides an insightful and more specific discussion of the problems with the FELA.

Sincerely,

William H. Dempsey, *President.*

Chicago and Northwestern Transportation Co.,
Chicago, IL, August 29, 1986.

Hon. Bob Packwood,
Chairman, Subcommittee on Surface Transportation, Senate Hart Office Building, Washington, DC.

Dear Mr. Chairman: This letter is in response to your request for comments by the Chicago and North Western Transportation Company on the testimony of Mr. G. W. Mahoney, Counsel to the Railway Labor Executives Association, at the regional railroad hearing before your subcommittee on July 25, 1986.

The concepts under which C&NW has evolved a regional feeder line railroad do not match the observations presented by Mr. Mahoney before the Surface Transportation Subcommittee. C&NW is convinced, in order to preserve rail service in areas that are marginally profitable or have declining bases, relief must be gained to provide major and innovative increases in productivity of both railroad labor and invested capital. C&NW is attempting to offer the opportunity for entreprenuerial investors to create independent and viable regional carriers that can compete in a deregulated environment with other modes of transportation and yet preserve capital investment incentive.

The movement of bulk commodities has historically been a major source of revenue for most of the U.S. rail system. With the advent of deregulation and the improved supply of oil in the world market, there has been a phenomenal growth of independent owner/operators in the trucking industry. The trucking industry has long been successful in competing with railroads in time sensitive merchandise and less than carload commodities. Under deregulated guidelines, the trucking industry has been a vigorous competitor in all commodities and in some cases has been able to establish bulk rates that are non-compensatory to a railroad, especially in the truck back haul mode where the owner/operator may accept a rate that covers only his costs of fuel and travel expenses back in the direction of his base.

Coupled with the above independent truck owner/operator, another major impact on the geographically small Class I railroad is the one line-one haul rate opportunities afforded the small Class I's normal shippers in areas served by the close proximity of the mega-Class I rail carriers. More than one mega-Class I rail carrier competes in C&NW's territory and these carriers have access to seaports on west and south coasts as well as most major domestic market areas served by C&NW. Major contributions to C&NW's revenues are produced in grain, related grain products and minerals. C&NW is competitively hard pressed and finds on many occasions that it cannot effectively compete against a combination low truck rate when the product is hauled from a C&NW served station with one line-one haul rate opportunities to destination.

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[2] See January/February 1986 Vol. 23 No. 1.

This is exactly the situation of the C&NW lines bounded by Winona, Minnesota and Rapid City, South Dakota. In 1985 C&NW had found it could no longer justify operations on 222 route miles of railroad in South Dakota and had prepared and filed cases for abandoning its operations on these lines. In addition, another 204 route miles in both South Dakota and Minnesota were highly questionable and on Class I Railroad cost basis show a declining traffic pattern and marginal profits. These lines, if abandoned, would have reduced the tonnage hauled over the remaining lines of C&NW, restrict the immediate competitive posture of the producing area served by the railroad and would have left the State of South Dakota without the benefits of an in place rail transportation system for future industrial growth and development. When rail lines are abandoned, the traffic generated by the lines is, in most cases, lost to the abandoning railroad and is not recoverable.

In an abandonment of rail lines there are usually provisions established by the Interstate Commerce Commission requiring a railroad to pay displaced employees a sum of money over a extended period of time before severing their employment relationship. Depending on the scope of the abandonment, number of employees and payment conditions imposed, these so called "job protection" provisions can more than offset the liquidated value of the abandoned property. The railroad will eventually gain some saving in the operating costs of the abandoned line. Between Winona and Rapid City 52% of C&NW's rail lines are positive losers or having declining traffic bases and are marginal at this time. There is an obvious public interest in keeping the majority of the lines operational. Imposition of job protection payments to employees of the lines would create a situation in which neither C&NW nor a new investor could structure a viable financial package that would support operation of the lines. The only alternatives available to C&NW would be to continue operations at a loss thereby weakening its total corporate viability or to progress abandonments irrespective of the public interest.

Mr. Mahoney states that imposed labor protection or conditions would not appreciably affect this transaction. Under abandonment cases, the Interstate Commerce Commission has normally imposed Oregon Short Line III conditions which generally provides for 6 years of salary protection. For the 169 employees on these lines such imposed labor protection would amount to slightly in excess of $34 million, $9 million more than the line is being sold for in an arms length transaction. This condition would be intolerable on the financial viability for creating an alternate to eventual abandonment of operation of the lines.

Within the framework of current Federal regulations, there are provisions that recognize and provide solutions to situations such as described herein. An entreprenuer, willing and able as an existing non-carrier to establish an operating company, may purchase lines of railroad which can be exempted from Interstate Commerce Commission imposition of labor conditions or job protection on either the purchaser or seller. The federal legislators and the Interstate Commerce Commission have recognized in this type of situation the public interest outweighs limited self-interest groups and the burden of labor conditions or job protection would indeed nullify the already speculative viability of a new company.

The formation of what will become the Dakota, Minnesota and Eastern Railroad Corporation was the result of negotiations between the C&NW and the L.B. Foster Company. The L.B. Foster Company is a Pittsburgh based non-carrier corporation in which C&NW has no financial interest or corporate control. L.B. Foster Company has previous successful experience in creating a regional rail carrier which was then sold to an investor group and today operates under independent charter as a new corporation.

The projected operating and financial plans for the new proposed regional carrier were subjected to intense scrutiny by investors to establish their financial viability and long term strength to market their services on a competitive basis. If the proposed pro-forma for the new carrier was marginal or had questionable assumptions or restrictive future obligations, it would not have qualified for financing. If labor protection provisions were imposed on either the buyer or seller of DM&E, the deal simply could not be structured. The net liquidation value of the lines is estimated by C&NW at approximately $19 million.

It is essential to the success of the new company that a strong and experienced team be formed to manage the operations. L.B. Foster Company asked C&NW to recommend qualified employees who might have an interest in managing the new company. C&NW management employees were to be considered along with potential available non-C&NW management personnel. C&NW agreed to open its non-confidential files of qualified management personnel to L.B. Foster who selected an experienced C&NW Assistant Vice President and Division Manager to be the nominated President of DM&E. Since DM&E was not yet a railroad, had no payroll system or medical, health or other insurance systems, C&NW agreed to continue to carry the nominated DM&E President on C&NW's payroll with total reimbursement by DM&E. Since June 2, 1986, C&NW has been billing the L.B. Foster Company for full reimbursement of the nominated DM&E President's salary and fringe benefits. C&NW has promoted an officer from within its management forces who filled the vacancy created by the new DM&E nominated President. Since June 2, 1986, all supervision and direction given to the DM&E nominated President has come from the principals involved in the L.B. Foster Company who are creating the DM&E.

Since June 2, 1986, several other C&NW employees have been hired by DM&E under the exact same conditions as the DM&E nominated President. None of these DM&E employees take any direction from C&NW.

It is not true that C&NW retains a financial interest in nor has C&NW "Loaned" DM&E money to begin operations. Because of DM&E's projected heavy initial investment in major rehabilitation of DM&E's lines, the Foster Group requested C&NW to defer payment of $4 million of the purchase price. C&NW agreed to do this in the form of a junior subordinated note which is less than half of the junior debt.

Since November 1985, at which time C&NW and the L.B. Foster Company agreed to an exclusive negotiation agreement, C&NW has made public and has widely disseminated the information concerning its intentions to sell the lines between Winona and Rapid City as an alternative to abandonments. This information and intent has been well received and supported by members of Congress, state and local government agencies and shippers along the lines. Even though the economic necessities dictate this transaction be progressed under Ex Parte 392 (Sub-No. 1) within the Interstate Commerce Commission jurisdiction, L.B. Foster's stated intention was to give preference to C&NW employees in DM&E's hiring practices. C&NW did negotiate a provision for DM&E to obtain resignations from C&NW employment by all C&NW employees who were hired by DM&E and actually received pay from DM&E. DM&E officers acting under the Foster Group's instructions held meetings with the current employees along the lines. The Foster Group advised C&NW that employees were reticent to sign a resignation form as a condition of employment. C&NW then voluntarily and unilaterally waived this provision of the agreement to facilitate hiring of C&NW employees by DM&E. Contrary to Mr. Mahoney's statement, C&NW has not initiated any individual contact among employees on these lines to discuss future employment by DM&E.

To illustrate the economic results of a short line (non-ICC imposed labor conditions), we would point toward the Chicago, Central and Pacific. CCP was formed after a sale by Illinois Central Gulf under section 10901 with no conditions imposed on buyer or seller by the Interstate Commerce Commission. CCP now operates the former ICG main line from Chicago to Council Bluffs with 2-2 man crews or a total of 4 men in this service per delivered train. C&NW, on the other hand, at the time CCP was formed operated this same service with 16 employees per delivered train and in the settlement of our most recent negotiations now can operate the service with 12 employees per delivered train.

If you have any further questions or require additional information, I would be pleased to respond. Thank you for the opportunity to provide our perspective on this subject.

Sincerely,

J.W. Conlon.

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